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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

Nos. 278, 279, 280, 281 and 282.

RECONSTRUCTION FINANCE CORPORATION; INSURANCE GROUP COMMITTEE, *et al.*,

Petitioners,

—against—

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, *et al.*,

Respondents.

(and the other four cases numbered above)

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF ON BEHALF OF RESPONDENT, CITY BANK FARMERS TRUST COMPANY, AS TRUSTEE UNDER THE DEBTOR'S GENERAL MORTGAGE.

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General Mortgage.

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ANGULO & COONEY,
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Of Counsel.

February 15, 1946.

THE COURT PRESS, N. Y. C.

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Opinions Below.

The opinion of the Circuit Court of Appeals for the Tenth Circuit (R. 233-262)* is reported in 150 F. (2) 28; that of the District Court approving the Plan (R. 187-206) is not reported; that confirming the Plan (R. 213-224) is reported in 62 F. Supp. 384.

Introductory.

This is a railroad reorganization case under Section 77 of the Bankruptcy Act.

* R. 1-368, inclusive, is in Vol. I of record printed pursuant to 7-10-45 stipulation; R. 369-896, inclusive, is in Vol. II, and R. 897-1229 is in Vol. III of additional record printed pursuant to 11-26-45 stipulation. The annual reports and financial statements are in a fourth, un-numbered volume.

The Interstate Commerce Commission in June, 1943, proposed a plan (herein called the "Plan") for the reorganization of The Denver and Rio Grande Western Railroad Company (herein called the "Debtor"). The Commission, on April 26, 1944, after approval by the District Court and while appeals from the approval order were pending in the Circuit Court of Appeals, submitted the Plan to the creditors for acceptance or rejection, under Section 77(e) of the Act. The General Mortgage Bondholders voted to reject the Plan, with 79⅓% of the total vote voting for rejection. The result of the voting was certified to the District Court by the Commission on July 4, 1944 (R. 265-274).

On August 30, 1944, the District Court held a hearing on the question of whether the Plan should be confirmed notwithstanding its rejection, and on November 1, 1944, rendered its opinion confirming the Plan (R. 213-224), its final orders being entered on November 29, 1944. Various parties, including this respondent, the Trustee under the Debtor's General Mortgage, appealed from the confirmation order.

In the meantime, the Circuit Court of Appeals for the Tenth Circuit on November 13, 1944, had heard the appeals from the approval order, but it withheld its decision on those appeals until the whole case should come before it. The appeals from the confirmation order were argued before the Circuit Court of Appeals on March 14, 1945. On May 10, 1945, the Circuit Court of Appeals rendered its decision on the appeals from both orders.

On the General Mortgage Trustee's appeal from the confirmation order, the Circuit Court of Appeals held unanimously that the rejection vote of the General Mortgage Bondholders was "reasonably justified"

within the meaning of the statute, and should not be overridden.

On all the appeals, the Circuit Court of Appeals held unanimously that the Plan is not fair and equitable, that it does not afford due recognition to the rights of the General Mortgage Bondholders, that it discriminates unfairly in favor of the other classes of creditors and that it does not conform to the requirements of the law of the land regarding the participation of the various classes of creditors.

The Circuit Court of Appeals did not undertake to decide the related constitutional question, viz. whether Section 77(e) should be construed as giving the District Court power to confirm a reorganization plan after a *majority* of the voting creditors of any class have rejected it. Decision of that question was unnecessary because of (a) the holding that the rejection vote was not of an unreasonable nature which should be overridden, and (b) the holding that the Plan was not fair and not equitable, and did not conform to the requirements of Section 77(e) of the Act.

Question Presented.

The statute provides that if the Plan has not been accepted by at least two-thirds of those voting of each class of creditors entitled to vote on it, the District Court may (subject to "the right of judicial review" by the Circuit Court of Appeals) nevertheless confirm the Plan if the Court is satisfied and finds, after hearing:

1. that the Plan makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it;

2. that the Plan affords due recognition to the rights of each class of creditors and stockholders;

3. that the Plan does not discriminate unfairly in favor of any class of creditors or stockholders;

4. that the Plan will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; and

5. that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts.

The statute provides that any confirmation by the District Court shall be "subject to the right of judicial review" before it becomes binding on a class of creditors who have rejected the Plan.

The Plan now under consideration was not so accepted. On the contrary, it was rejected by 79.3% of the General Mortgage Bondholders who voted upon it.

The ultimate question presented is whether or not the General Mortgage Bondholders were "not reasonably justified", within the meaning of the statute, in rejecting the Plan.

That ultimate question requires examination of the terms of the Plan and its effect, to ascertain whether the General Mortgage Bondholders were accorded treatment to which a reasonable person, considering his own interests, could not reasonably object.

In answering that ultimate question, additional questions are presented relating to the compliance of the Plan with each of the statutory provisions above enumerated.

The unanimous Circuit Court of Appeals held (R. 253):

> "Under the admitted facts of the case, whether the plan complies with the requirement of Section 77(e) presents a pure question of law, and we are in nowise bound by the legal conclusions of the District Court in this respect. It is our conclusion that the plan fails to meet the requirements of Section 77(e). * * *."

It also held unanimously (R. 253):

> "* * * that the General Bondholders were reasonably justified, within the meaning of the statute, in rejecting the plan, and that the District Court was without authority to confirm the plan in the face of their adverse vote."

The Statute.

Section 77(e) of the Bankruptcy Act (11 U. S. C. A., Sec. 205(e), pp. 93-5) provides in part:

> "* * * The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed * * * for acceptance or rejection, * * *. The Commission shall certify to the judge the results of such submission.
>
> "Upon receipt of such certification, * * * if the plan has not been so accepted by the creditors [*i. e.*, by * * * creditors of each class * * * holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported * * * as voting on said plan] * * *, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified

in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the Plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e) [i. e., * * * that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders; does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) * * *; (3) * * *.] * * * If the judge shall not confirm the plan, he shall * * * enter an order in which he shall either dismiss the proceedings, or * * * refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. * * *"

Section 77(f) of the Bankruptcy Act (11 U. S. C. A., Sec. 205(f), p. 95) provides in part:

"(f) Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon * * * all creditors * * * who have not, as well as those who have, accepted it."

STATEMENT.

The Debtor's General Mortgage.

This respondent, City Bank Farmers Trust Company, is the trustee of the Debtor's General Mortgage, under which $29,808,000, principal amount, of General Mortgage Bonds are outstanding (R. 37). The total General Mortgage claim, including accrued unpaid interest of $43,740,155, as of the proposed effec-

date of the Plan, January 1, 1943, aggregated about 43½ million dollars (R. 183). The General Mortgage Bonds constitute almost one-fourth of the Debtor's entire indebtedness. They are the Debtor's junior bonds.

The holders of the General Mortgage Bonds voted, by 79.33% to 20.67% of those voting, to reject the Plan (R. 266).

There is no committee representing the holders of the General Mortgage Bonds. The holders are numerous; the individual holdings are small. This respondent, the General Mortgage Trustee, is the only representative of this class of creditors participating in the case. It made no recommendation to any bondholder as to how he should vote on the Plan (R. 337-8).

Notwithstanding these facts, holders of 21.6% (R. 268) of the outstanding General Mortgage Bonds cast their vote—enough to give a representative ballot as contemplated by Section 77, as amended by the August 27, 1935 amendments.

The Plan.

The Plan was proposed by the Interstate Commerce Commission in its Third Supplemental Report and Order dated June 14, 1943, 254 ICC 349 (R. 151-186). The Plan is in the alternative, with or without consolidation with the Denver & Salt Lake (an independent corporation sometimes called the "Moffat Road"). A summary of the Plan, without such consolidation, is given in Appendix B to the Commission's report (R. 183), a total capitalization of $143,528,027 being authorized (R. 159, 184). In this brief, to avoid confusion, figures applicable to reorganization without such consolidation always will be used.

The total capitalization of approximately 143½ million dollars may be obtained from the figures in the Commission's Appendix B (R. 183). It includes the notes to be held by the two collaterally-secured creditors, the Chase National Bank and the R. F. C., at their face amount only. The total does not include the authorized new securities to be issued by the reorganized Debtor and pledged as collateral* for those notes.

Under the Plan the General Mortgage Bondholders receive 10% of their claim in new common stock (being about 12% of the authorized common stock). The other 90% of their claim is wiped out. The Plan eliminates claims aggregating, as of the proposed effective date, over $118,300,000 (R. 36-7, 183), consisting of (a) about 39 million dollars of the General Mortgage claim, (b) the Debtor's unsecured indebtedness of about 440 thousand dollars, (c) the Debtor's preferred stock outstanding in the amount of 16½ million dollars, and (d) the Debtor's 300,000 shares of common stock, carried on the balance sheet at about 62½ million dollars.

As the Plan has been construed, were it now to be put into operation, the capitalization of the reorganized Debtor would be substantially less than the 143½ million dollar amount authorized by the Commission.

This reduction results from the elimination of some of the senior debt by application of "surplus cash" earned and accumulated since the Plan was proposed by the Commission.

For purposes of comparison it might be noted that the Debtor's Trustees carry the Debtor's assets on

*A large part of the collateral for the R. F. C. note consists of securities not issued by the Debtor (R. 18).

their balance sheets at $302,692,146.59,* of which over 239 million dollars represents road and equipment and over 19 million dollars is in cash or temporary cash investments.

The earlier plans.

At least ten other reorganization plans have been proposed for this Debtor since the institution of these proceedings. Certain features of the several plans may be summarized as follows:

Plan†	Date proposed	Authorized capitalization (A)	Percentage of claim of General Mortgage Bonds provided for in new stock (B)	Percentage of total authorized common stock allocated to General Mortgage Bonds
Debtor's	7 29 36	$158,747,766	100%	0
Insurance Group I	6 15 37	149,732,966D	100%	100%
Examiner's I	8 12 38	137,154,585	50%	50%
ICC I	7 31 39	135,788,354	33⅓%	33%
ICC II	4 11 40	135,788,354	33⅓%	33%
Discussion	1 6 41	135,005,436E	50%	44%
District Court's	3 6 41	136,960,724	32.99%	35.2%
Examiner's II	9 2 41	157,540,952	33⅓%	32.6%
Insurance Group II	10 8 41	161,631,934	47.42%	46%
ICC III	7 27 42	142,846,612	5%	5%
ICC IV (the "Plan")	6 28 43	143,528,027F	19%	12%

* Income Account and Financial Exhibit for the period ended December 31, 1944, p. 5.

† For key to plans see continuation of this footnote, p. 10.

A. Figures based upon reorganization of the Debtor *without* consolidation with the Denver and Salt Lake.

B. The Debtor's plan allotted preferred stock to the General Mortgage Bondholders; all subsequent plans common stock. The percentages given relate to the entire claim, including interest to proposed effective date.

C. The Debtor's plan gave General Mortgage Bonds 80.1% of the new preferred stock to be outstanding.

D. Exclusive of warrants for old stock.

[Footnotes continued on following page.]

As indicated in the foregoing table, these plans have provided varying treatment for the General Mortgage

(Footnotes continued from preceding page.)

E. Plus $10,000,000 of claims to be paid in cash.

F. Because of reductions in senior claims outstanding since 6, 28 43, the amount to be outstanding would now be less than 140 million dollars.

Key to Plans

"Debtor's"—Debtor's original plan of July 28, 1936—filed July 29, 1936, proposed effective date January 1, 1937 (R. 401-426, 426A).

"Insurance Group I"—First plan of Insurance Group Committee—filed June 15, 1937, proposed effective date January 1, 1937 (R. 427-466, 458A).

"Examiner's I"—I. C. C. Examiner Jameson's first plan—filed August 12, 1938, proposed effective date June 30, 1938 (R. 466-526, 518).

"ICC I"—Commission's first plan of July 11, 1939, filed July 31, 1939, proposed effective date June 30, 1938 (R. 29-97, 352).

"ICC II"—Commission's modified plan of April 2, 1940—filed April 11, 1940, proposed effective date June 30, 1938 (R. 98-112).

"Discussion"—So-called discussion plan of October 28, 1940—proposed as a compromise by Insurance Group Committee after conferences with R. F. C.—filed January 6, 1941, proposed effective date June 30, 1938 (R. 549-559, 554A).

"District Court's"—District Court's plan (R. 559-568, 568A) in Opinion of and filed March 6, 1941, proposed effective date June 30, 1938. (The District Court also tentatively suggested a plan outline in its preliminary opinion of December 6, 1940 (R. 526), calling a conference of the parties. After the conference that outline was superseded by the Court's plan in its March 6, 1941 final opinion on the Commission's 1940 plan.)

"Examiner's II"—I. C. C. Examiner Jameson's plan of August 26, 1941—filed September 2, 1941, proposed effective date January 1, 1942 (R. 569-604, 604A).

"Insurance Group II"—Insurance Group plan filed October 8, 1941, proposed effective date January 1, 1942 (R. 604B).

"ICC III"—Commission's plan of July 13, 1942—filed July 27, 1942, proposed effective date January 1, 1942 (R. 113-150, 353-6).

"ICC IV" (in this brief usually called the "Plan" but designated as "ICC IV" in the charts)—Commission's plan of June 14, 1943—filed June 28, 1943, proposed effective date January 1, 1943 (R. 151-186).

Bonds. The first two plans gave them 100% of their claim in new preferred or Class A common stock. The present Plan gives them 10% of their claim in common stock. The three plans proposed at various times by the senior creditors offered the General Mortgage Bondholders a maximum of 100% and a minimum of 47.42% of their claim in new stock.

The treatment proposed in these eleven plans and the current earnings of the property in the years in which the several plans were proposed are tabulated as follows:

Date of plan proposal	Plan	Amount of common stock provided on total General Mortgage claim	Current income available for interest in year plan proposed **
7 29 36	Debtor's	100% *	$ 1,626,179
6 15 37	Insurance Group I	100%	— 294,880
8 12 38	Examiner's I	50%	10,018
7 31 39	ICC I	33⅓%	1,717,298
4 11 40	ICC II	33⅓%	2,626,847
1 6 41	Discussion	50%	4,358,182
3 6 41	District Court's	32.99%	4,358,182
9 2 41	Examiner's II	33⅓%	4,358,182
10 8 41	Insurance Group II	47.42%	4,358,182
7 27 42	ICC III	5%	17,180,067
6 28 43	ICC IV	10%	11,766,741
1 1 44	Submission of Plan to Gen. Mtge. Bonds		$10,025,132

* Preferred stock.

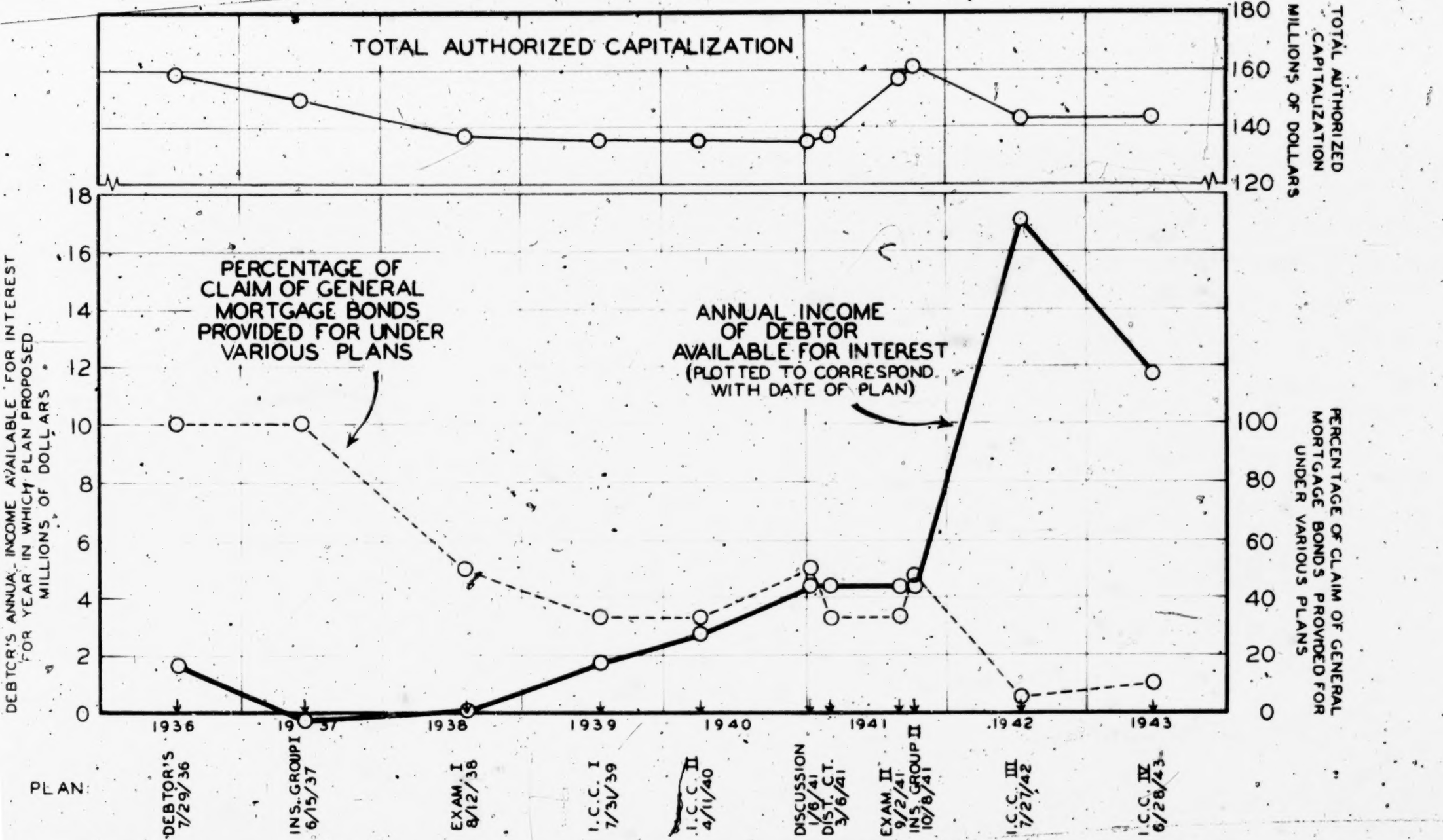
** See more detailed earnings table below (this brief 18).

The treatment proposed and the current earnings in each of such years are also shown graphically, and compared, on the chart opposite this page. The broken line connects the eleven points which show the percentage of the total General Mortgage claim provided for in each of the eleven plans (scale at right). The heavy line connects the eleven points which show the available income earned in the respective years in which the eleven plans were proposed (scale at left). This chart shows that, as the earnings have improved, the treatment proposed for the General Mortgage Bonds has steadily worsened. The unbroken line at the top shows the authorized capitalization in the eleven plans, which has not fluctuated greatly, notwithstanding the extraordinarily heavy improvement program which has been carried out, and paid for out of the earnings which accrued during the pendency of these reorganization proceedings—earnings which might have been used, but were not used, to pay interest on the indebtedness which is prior in lien to the General Mortgage.

The improvement program.

During the reorganization period the Debtor's Trustees have carried on an improvement program of extraordinary proportions. When the magnitude of the program first became apparent, the General Mortgage Trustee, on July 17, 1936, filed its answer to a petition of the Debtor's Trustees for authority to borrow money for the purpose of carrying out the initial portion of the program (R. 398-401). This respondent urged the Court to eliminate from the schedules of proposed improvements all items not shown to be essential for the safe operation of the property or its preservation (R. 400). After hearing,

TREATMENT OF GENERAL MORTGAGE CLAIM PROPOSED IN ELEVEN REORGANIZATION PLANS COMPARED WITH DEBTOR'S INCOME AVAILABLE FOR INTEREST IN YEAR OF PROPOSAL



THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, DEBTOR

the Court overruled the objections of this respondent and directed its Trustees to proceed with the program.

The decision of the District Court and its Trustees to proceed with this program and to divert earned income, otherwise available for payment of interest on the senior bonds, into permanent additions and betterments of the Debtor's property, much of it at a low cost, turned out well for the trust estate.

The extent of the program can be determined by a study of the annual reports which show the "increase" in investment in road and equipment, for the years in question, in special tables. It appears from the following tabulation that up to July 31, 1944 (the end of the last month prior to the confirmation hearing), the additions and betterments charged to capital account aggregate over 43 million dollars and about 11 million dollars more, charged to income, was spent during the same period in connection with these improvements, making a total of over 54 million dollars so expended:

Period	Expenditures incident to improvement work	Additions and betterments charged to capital accounts	Total
1935 (last 2 mos.)	$ 30,000*	$ 90,000*	$ 120,000*
1936	2,910,726†	2,079,254	4,989,980
1937	1,450,349	4,270,728	5,721,077
1938	559,926	2,877,090	3,537,016
1939	1,129,075	2,970,334	4,099,409
1940	1,056,410	3,363,452	4,419,862
1941	1,180,750	6,071,534	7,252,284
1942	950,057	6,127,558	7,077,615
1943	1,014,432	9,772,823	10,787,255
1944 (first 7 mos.)	700,000*	5,688,740	6,388,740
1944 (to 12/31/44)	1,464,059	6,827,071	8,291,130
Totals (to 8/1/44)	$11,081,725	$43,291,513	$54,373,238
Totals (to 12/31/44)	$11,845,784	$44,449,844	$56,295,628

* Estimated.

† Includes $2,000,000 for maintenance work in 1936 deferred in prior years.

The figures in the foregoing table relate to improvements on the Debtor's property only and do not include the additions and betterments on leased lines (the Debtor's subsidiaries), or expenses incident thereto. If these were included, it would increase the total by about 2½ million dollars.

The petitioners object to the 43 million dollar figure cited by the Circuit Court of Appeals (R. 243), stating that it does not give a full picture because it does not reflect retirements during the same period. The retirements during that period, *i. e.*, up to August 1, 1944, aggregate about 13 million dollars. That amount could be subtracted and there would still remain a net gain for capital account of more than 30 million dollars. It is submitted, however, that such a subtraction would not be fair or accurate. A large part of the retirements in question were abandonments. It was pointed out in the expert testimony of the witness, Miles C. Kennedy (R. 332), that the Commission does not authorize abandonments until it is satisfied that the property to be abandoned has been a drain on the system and has been consistently losing money. If a useless and money-losing piece of road is abandoned, that particular transaction constitutes gain and not loss with respect to the Debtor's net value for reorganization purposes, notwithstanding the fact that the book value of the abandonment decreases the total book value of the property.

The senior creditors.

The petitioners, who would have the Plan confirmed notwithstanding its rejection by the General Mortgage Bondholders, are senior creditors. Under the Plan they are to receive the full face amount of their respec-

tive claims, principal and accrued interest, in Plan securities (R. 183). The senior creditors are to receive outright (except for 12% of the common stock) the Debtor's railroad system. It is a greatly improved railroad. It is a railroad system on which, up to July 31, 1944 about 54 million dollars of earnings accumulated during the pendency of the proceedings had been spent on additions and betterments over and above normal maintenance.

Because the available earnings have been plowed back into property, in betterments and improvements, instead of being used to pay interest on the claim of the senior creditors during the period between November 1, 1935 and December 31, 1944, the claim of the senior creditors has increased by about 40 million dollars, on account of accrued interest, and new securities of that total face amount, which would otherwise have been available for distribution to the General Mortgage Bondholders, have been re-allocated to the senior creditors. This resulted from the fact that there has been no substantial increase during the pendency of the proceedings of the total amount of securities to be authorized for the reorganized Debtor, even though, by the investment of approximately 54 million dollars, the railroad to be owned by the holders of the new securities, and the earning power of that railroad, have been vastly improved. Thus the treatment of the senior creditors in the Plan is both quantitatively and qualitatively better than that provided in the earlier plans.

Under the Plan, one class of senior creditors is to receive, in addition to 100% of its total claim in new securities, all of the stock of Utah Fuel Company, on which stock this respondent has a junior lien.

The institutions which are members of the Insur-

ance Group Committee, one of the principal petitioners, own no General Mortgage Bonds (R. 428). The same is true of the R. F. C. (R. 39). The other petitioners are trustees of the senior mortgages.

The impounding petition.

The General Mortgage Trustee acted promptly to make sure that any net income from the mortgaged property should be impounded for the benefit of the General Mortgage Bondholders. Its impounding petition was filed on November 19, 1935, a few weeks after the institution of the reorganization proceedings (R. 376-398, 397).

After that impounding petition was filed and up to the end of 1944 the property which is subject to the General Mortgage lien produced earnings of approximately 50 million dollars, or over 9 million dollars more than enough to cover full interest requirements on the senior securities—the surplus to that date being about $9,389,418.

Earnings.

The Debtor's earnings record has been good except for the depression years. In the six years preceding the depression, 1925 to 1930, inclusive, the Debtor's net income available for interest ranged between $6\frac{1}{2}$ and $8\frac{3}{4}$ million dollars annually (R. 348). The interest requirements for all creditors senior to the General Mortgage total between 4 and $4\frac{1}{2}$ million dollars annually (R. 349). The annual interest charges on the General Mortgage Bonds amount to about $1\frac{1}{2}$ million dollars.

Since the end of 1941 (by which time a substantial

part of the 43-million-dollar expenditure for additions and permanent improvements had been made), the Debtor's net available for interest has been running between 10 and 17 million dollars annually (R. 280-1, 348, 349). There is undisputed testimony that the improvements can be expected to yield a return of 10% to 15% or even more (R. 346-7). That would indicate an increase in earnings, resulting from the improvements, of between 4 and 6½ million dollars in an average year.

As already pointed out, from the institution of these reorganization proceedings in 1935 up to the end of 1944 the Debtor's income available for interest has exceeded total interest requirements for all creditors' claims senior to the General Mortgage Bonds by more than 9 million dollars. Thus there has been an average of over one million dollars a year of earnings available for the General Mortgage Bonds, being approximately two-thirds of the contract interest requirements of that junior issue. This period involves the six worst years in the present company's history (R. 348).

The figures were tabulated in this Respondent's Exhibit 10 (R. 349) introduced at the confirmation hearing. With a slight correction in the figures for 1944 (which had been estimated), this table showed the following:

Year	Income available for interest*	Interest requirements for securities senior to General Mortgage*	Income (or deficit) after interest on senior securities
1935 (last 2 mos.)	$ 405,418	$ 701,818	$ — 296,400
1936	1,626,179	4,182,219	— 2,556,040
1937	— 294,880	4,160,664	— 4,455,544
1938	10,018	4,179,725	— 4,169,707
1939	1,717,298	4,184,227	— 2,466,929
1940	2,626,447	4,206,933	— 1,580,086
1941	4,358,482	5,169,696	— 811,574
1942	17,180,067	4,382,701	+12,797,366
1943	11,766,791	4,368,551	+ 7,398,160
1944 (first 7 mos.)	5,992,635	2541,745	+ 3,450,890
1944 (12 mos.)	10,025,132**	4,495,020	+ 5,530,112
Total for whole period 11 1 35 to 12 31 44	$49,420,972	$40,031,554	$+ 9,389,418

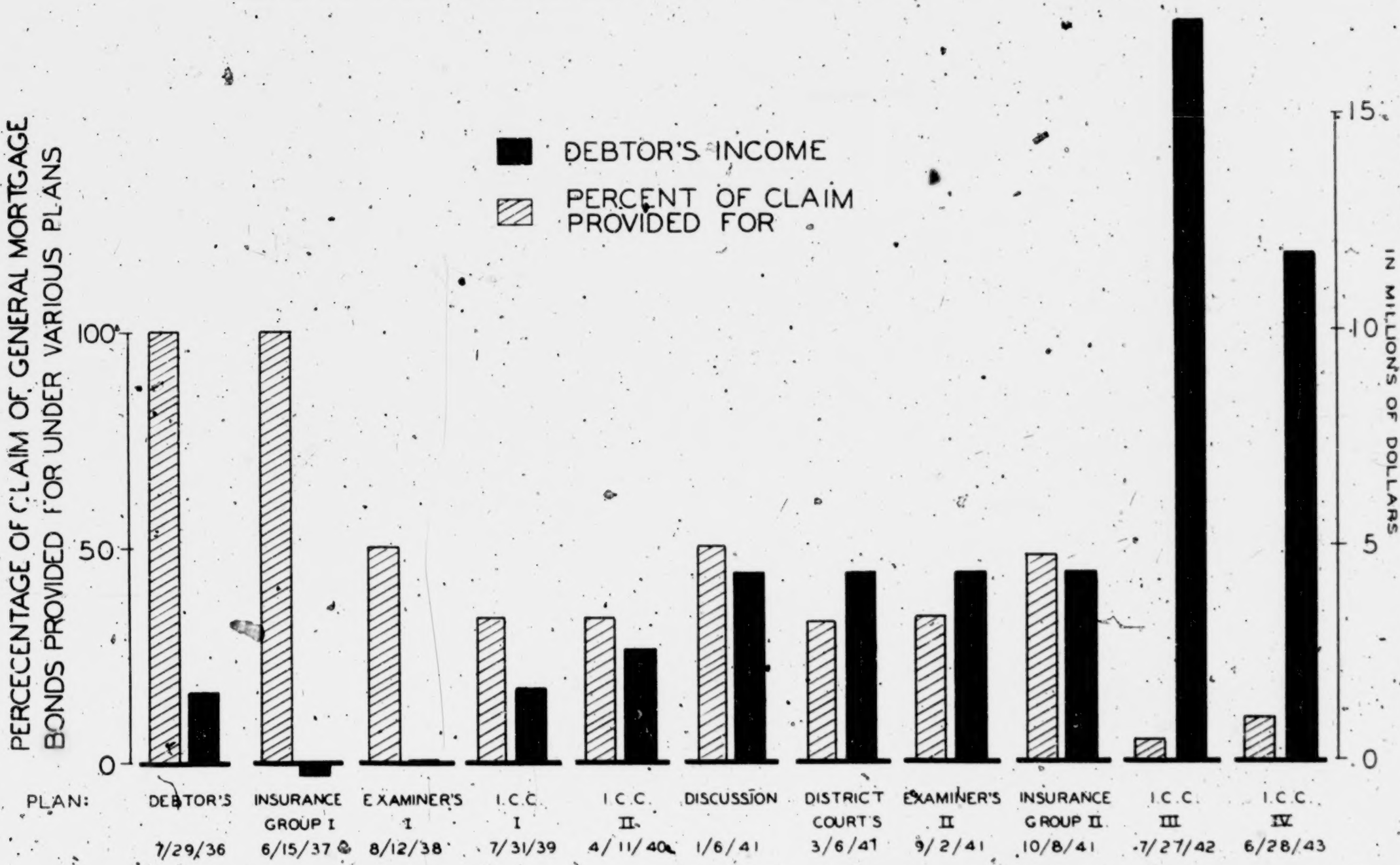
The $49,420,972 of income available for interest shown in the foregoing tabulation is an existing fact; it is not dependent on hypothetical future earnings. It has been retained in the Debtor's estate and is today in existence—either in the form of cash and government bonds or in the form of permanent capital improvements.

What has happened during the course of the reorganization period is shown graphically on the chart opposite the next page, which compares the treatment of the General Mortgage Bonds proposed in the eleven

* Interest figures include interest on unfunded debt. The source of the figures up to August 1, 1944 are Trustees' Annual Report, 1943, page 32, computed as directed by T. A. Thompson, General Auditor (R. 279-89) and August 1943 and July 1944 Income Account Statements.

** The figure in the Trustees' December 1944 Income Account Statement, p. 1, is $8,490,992.45. It has been adjusted for this table and brief by adding back the item of "Delayed Income Debits" which appears for the first time in the December 1944 Statement, and amounts to $1,534,139.75. This item is accumulated rental on the Cut-off during *earlier years* of trusteeship, *all* paid in 1944 to the Trustee of the wholly-owned Subsidiary Debtor. This item in essence represents funds transferred from one pocket to the other and should not be deducted from Gross Income in arriving at a true representation of the Debtor's income available for interest

TREATMENT OF GENERAL MORTGAGE CLAIM PROPOSED IN ELEVEN REORGANIZATION PLANS COMPARED WITH DEBTOR'S INCOME AVAILABLE FOR INTEREST IN YEAR OF PROPOSAL



THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, DEBTOR

plans previously described with the current earnings of the property in the years in which the several plans were proposed. Each set of two bars relates to one of the eleven plans. The lightly-shaded bar of each set shows the treatment proposed in the plan in question (scale at left). Thus, the first two plans proposed giving the General Mortgage Bonds new stock equal to 100% of their claim, principal and accrued interest; the most recent Plan proposes giving the General Mortgage Bonds 10% of their claim. The solid-black bars show the Debtor's income available for interest as of the year in which the particular plan in question was proposed (scale at right). Thus, in 1937, when the Insurance Group proposed its first plan (providing that the General Mortgage Bondholders should receive 100% of their claim in new Class A common stock), there was a net deficit before interest. In 1943, when the Plan now under consideration was proposed, the income available for interest amounted to $11,766,711.

The 1944 income available for interest is not shown on this chart although the figures were available in the courts below. As shown on the previous table, the 1944 available income was $10,025,132. It was in 1944 that the General Mortgage Bondholders were called upon to vote on the question of accepting or rejecting the Plan, which asked them to accept 10% of their total claim in new common stock in full satisfaction of their claim.

In an effort to show insufficiency of earnings the petitioners present their Appendix F, dealing with many years prior to these proceedings. Assuming their arithmetic correct, that table bears no relation to the actual facts regarding interest coverage.

On the next page is an interest-coverage table in which we have limited ourselves to the figures actually recorded in the annual reports. The earliest year for which figures are available in the record is 1915. For the years 1915 through 1944 we have taken from the annual reports (I) total operating revenues, (II) net operating revenues, (III) earnings available for interest on funded debt (after all taxes and interest on unfunded debt), (IV) interest on the senior bonds, and (V) the amount available for interest on the General Mortgage Bonds.

The General Mortgage Bonds were not issued until 1924. Full interest requirements on the General Mortgage Bonds, being $1,490,400 per year (5% on $29,808,000) would amount to $44,712,000 for the period 1915 to 1944, inclusive. Column V shows that the actual amount earned by the Debtor, available to cover such interest, was $54,409,082, or $9,697,082 more than required.

If we are to delve into the record of earnings for a period long prior to these proceedings, the only figures entitled to serious consideration are the actual results of operation. It is meaningless, if not misleading, to present a table, such as the petitioners' Appendix F, to which various hypothetical factors and assumptions have been applied for the purpose of building up a theoretical deficit of 60 million dollars, which might have resulted under a chosen set of circumstances but which actually bears no relationship to reality. The fact is that the earnings of the Debtor, after all senior interest, have exceeded the amount of all interest on the General Mortgage Bonds for this 30-year period by $9,697,082.

Earnings available for interest on all bonds senior to the General Mortgage and for interest on the General Mortgage Bonds for the period 1915 to 1944.

	I	II	III	IV	V
	Total Operating Revenues	Net Operating Revenues	Available for Interest on Funded Debt	Interest on All Bonds Senior to General Mortgage	Available for Interest on General Mortgage Bonds
1915	23,138,797	8,892,439	8,354,335	3,313,465	5,040,870
1916	25,464,486	10,588,131	10,019,696	3,305,965	6,713,731
1917	28,423,138	8,694,709	7,722,220	3,282,865	4,439,355
1918	31,352,214	6,058,789	6,995,867	3,279,740	3,716,127
1919	33,016,257	7,359,285	5,732,699	3,279,740	2,452,959
1920	40,590,345	8,037,098	9,508,213	3,279,740	6,228,473
1921	32,621,419	4,875,329	3,303,907	3,279,740	24,167
1922	33,350,564	7,945,789	5,166,973	3,279,740	1,887,233
1923	34,587,497	4,556,828	2,819,749	3,418,958	*—599,209*
1924	33,011,558	4,420,401	2,394,626	3,816,410	*—1,421,784*
1925	33,629,464	8,835,215	6,788,296	3,619,229	3,161,067
1926	34,039,309	9,415,995	7,705,670	3,665,553	4,040,117
1927	36,124,169	8,041,953	6,472,257	3,690,371	2,775,886
1928	33,200,656	8,758,241	7,314,899	3,870,517	3,444,382
1929	34,828,669	10,293,502	8,811,533	3,890,698	4,920,835
1930	29,747,537	9,051,736	7,068,617	3,893,936	3,174,681
1931	23,484,818	7,061,678	5,142,666	3,877,918	1,264,748
1932	17,560,621	4,850,144	2,739,793	3,833,089	*—1,093,810*
1933	17,412,794	5,225,370	3,140,746	3,789,299	*—648,553*
1934	19,246,850	4,601,589	2,260,019	3,745,491	*—1,485,472*
1935	20,944,250	4,808,762	1,929,183	3,707,582	*—1,778,399*
1936	25,599,309	4,660,350	1,422,333	3,678,373	*—2,256,040*
1937	26,781,992	2,656,275	*—798,596*	3,656,948	*—4,455,544*
1938	23,404,171	3,661,691	*—195,698*	3,676,009	*—4,469,707*
1939	25,073,039	4,809,678	1,213,382	3,680,511	*—2,466,929*
1940	26,219,195	5,740,324	2,120,496	3,700,582	*—1,580,086*
1941	31,572,624	7,353,504	2,910,045	3,721,559	*—811,514*
1942	54,475,496	23,214,802	16,529,932	3,732,566	12,797,366
1943	70,194,002	24,392,502	11,116,576	3,718,416	7,398,160
1944	70,346,987	20,569,809	7,699,535	3,703,563	3,995,972
1915-1944	966,130,236	248,333,838	162,804,175	108,395,093	54,409,082

From 2nd Column, Top Table, p. 29, 1935, 1943 and 1944 Annual Reports
From 6th Column, Top Table, p. 29, 1935, 1943 and 1944 Annual Reports
From 9th Column, Top Table, p. 32, 1935, 1943 and 1944 Annual Reports (this is after interest on unfunded debt)
From Total Interest on Funded Debt (1st Column, Middle Table, p. 32, 1935, 1943 and 1944 Annual Reports) less interest on General Mortgage Bonds (6th Column, Middle Table, p. 32, 1935, 1943 and 1944 Annual Reports) or interest on Adjustment Mortgage and First and Refunding Mortgage Bonds (1st and 2nd Columns, Bottom Table, p. 32, 1935 Annual Reports) in exchange for which General Mortgage Bonds were issued in the 1924 Reorganization.

One important factor to which neither the petitioners' Appendix F nor the foregoing table gives any weight is the extraordinary improvement program carried out during the last few years. It should add 4 to 6 million dollars, or more, to the Debtor's income on the basis of the expert testimony of Miles C. Kennedy (R. 316-7).

In another effort to show insufficiency of earnings, the petitioners say that "For many years one of the most pervasive and fundamental trends in the railroad industry has been the seemingly inexorable advance in unit costs". This assumption appears repeatedly (petitioners' brief 16, 17, 33, 60, 61, 62, 79). What are the facts? In the yearbook of Railroad Information—1944 edition, published by the Eastern Railroad Presidents' Conference Committee on Public Relations, operating revenues and operating expenses of the Class I railways are tabulated from ICC figures for typical years from 1916 to 1943. From this table, it will be noted that there has been an over-all decrease in the ratio of operating expenses to operating revenues, as follows:

1918	81.6%	1935	75.1%
1921	82.7%	1936	72.3%
1926	73.2%	1937	74.9%
1928	72.5%	1938	76.3%
1929	71.8%	1939	73.0%
1930	74.4%	1940	71.9%
1931	77.0%	1941	68.5%
1932	76.9%	1942	61.6%
1933	72.7%	1943	62.5%
1934	74.6%		

Thus, the fact is that improvements in the art of railroading are steadily decreasing the operating ratio in

spite of the alleged "*seemingly* inexorable advance in unit costs" (emphasis supplied).

Cash and working capital.

The cash, current assets and net working capital of the Debtor's Trustees have shown a favorable trend throughout the period of these proceedings, and the improvement since January 1, 1943 (the proposed effective date of the Plan) has been impressive. For convenience, the following table has been prepared giving the figures which appear in the annual reports:

As of 12/31	Cash	Current assets	Current liabilities	Net working capital
1935	$ 1,257,943	$ 5,966,667	$15,545,219*	*$−9,578,552*
1936	1,282,525	8,025,321	11,446,128*	*−3,420,807*
1937	1,386,679	9,640,322	11,972,533*	*−2,332,211*
1938	2,337,018	8,229,639	7,867,770*	361,869
1939	3,284,015	8,622,087	8,166,536*	455,551
1940	4,328,184	9,553,783	8,412,669	1,141,114
1941	4,460,157	11,828,589	10,292,313	1,536,276
1942	10,850,150**	20,983,653	14,172,576	6,811,077
1943	20,721,925**†	33,915,864†	23,517,780	10,398,084†
1944	19,142,676**‡	32,665,501‡	20,539,638	12,125,863‡

The figures in the last column, showing net working capital, are obtained by subtracting current liabilities from current assets.

From the above it appears that as of January 1, 1943 (the proposed effective date of the Plan) the

* The first five figures under "current liabilities" were obtained by subtracting from the annual report figures for those years the items of "Interest Matured Unpaid" and "Funded Debt Matured Unpaid"; in the later annual reports those two items are not listed as current liabilities.

** Includes temporary cash investments.

† Does not include $3,751,995 set aside for deferred maintenance (R. 278; 1943 annual report, p. 12).

‡ Does not include $5,652,150 set aside for deferred maintenance (Income account and financial exhibit, December 31, 1944, p. 5).

net working capital was $6,811,077 and included in the current assets was cash amounting to $10,850,150. By the end of 1944 both of these figures had almost doubled.

Considering the whole period of the reorganization proceedings, the net working capital position has improved by $21,704,415 and the cash position in the meantime has improved by $17,884,733—if we exclude the sum of $5,652,450 set aside in account No. 704½ as "Maintenance Funds"—and by $23,536,923 if that special account is included.

The Circuit Court of Appeals (R. 247) points out:

> "We think it is apparent from the record that there were current assets on hand consisting of cash and securities in excess of what was needed for the efficient operation of the road. * * * we cannot disregard the fact that these huge surpluses actually exist. Their existence is an accomplished fact. * * * We think any plan which fails to take this into account and which gives the Senior Bondholders their claims in full by substantially delivering the road to them, and gives them the surplus cash actually on hand * * * is inherently inequitable and unfair, so long as there are classes of creditors whose claims are not fully satisfied."

The Circuit Court of Appeals further points out (R. 248):

> "* * * In his order of September 13, 1943 [nine months after the effective date of the Plan], directing the payment of the Junction Bonds in cash, the [District] court said: 'The trustees having on hand an amount of cash *far in excess** of

* Italicized in original; unless otherwise indicated, all emphasis in quotations is supplied.

the needs of reorganization expenses, including working capital * * *."

The Junction Bonds.

Of the 142½-million-dollar capitalization authorized in the 1943 Plan, about 2¾ million dollars of new senior securities were to be issued in exchange for the Junction Bonds (the First Mortgage Five Per Cent Bonds of The Rio Grande Junction Railroad Company, a wholly-owned subsidiary of the Debtor, owning that part of Debtor's main line from Rifle to Grand Junction, Colorado). Of these, $2,123,916 are new fixed-interest bonds and $634,417 are new income bonds (R. 183).

Some nine months after the proposed effective date of the Plan, the District Court directed that the Junction Bonds be paid or purchased by the application of "surplus cash" (R. 262, 263, 264-5). In that way, the first lien upon the Junction property, amounting to approximately 2¾ million dollars, has been eliminated—without issuing any of the 2¾ million dollars of authorized Plan securities which the Commission had allocated to that particular purpose and without depleting the cash below the amount contemplated in the Plan. After the application of this surplus cash, more cash and "net current working capital" remained than were on hand at the time the Plan was promulgated (R. 278, 298).

This respondent petitioned the District Court to redistribute the authorized Plan securities no longer required for acquisition of the Junction Bonds (R. 637-40). Such a redistribution would have "sweetened" the assortment of new securities allotted to each class of senior creditors and would have made available, at the bottom of the list, an additional 2¾

million dollars of common stock for allocation to the General Mortgage Bondholders.

The District Court denied the petition saying that it did not believe that it had "the power to make the reallocation requested by the General Mortgage" Trustee. (R. 217).

This respondent appealed from that ruling (R. 650-655) as well as from the confirmation order. The Circuit Court of Appeals agreed with this respondent that the Plan securities originally intended for the Junction Bondholders should be redistributed (R. 250-1).

The Utah Fuel stock.

The Rio Grande Western Railway Company (a predecessor of the Debtor), in 1901 bought all the stock of Utah Fuel Company for $6,000,000 and paid for the stock by putting the stock under the Western Consolidated Mortgage (one of those senior to the General Mortgage) and issuing $6,000,000 of Western Consolidated Bonds to the former owner of the stock (R. 1080, 1097). The Railway Company was entitled to receive back the stock, free of the lien of the Western Consolidated Mortgage, upon payment of $6,000,000 to the trustee of that mortgage.

In 1918, the equity in the stock (then owned by The Denver and Rio Grande Railroad Company, a predecessor of the Debtor) was sold (R. 1082, 1097). Thereafter the Western Pacific acquired title to that equity (R. 1082-3). At that time the Western Pacific and the Missouri Pacific each owned one-half the capital stock of the Debtor (R. 33).

As of December 20, 1924, the Western Pacific and the Debtor entered into an agreement with the Missouri Pacific and James S. Alexander, as trustee,

whereby the Utah Fuel stock was transferred to Alexander, as trustee, still subject, however, to the lien of the Western Consolidated Mortgage (R. 1081-86). By this agreement the Western Pacific assigned to the Missouri Pacific one-half its interest in the Utah Fuel stock "subject to the Consolidated Mortgage, and to the provisions of this agreement". It was then provided that the income from the stock should be paid to the Debtor as long as any of the Debtor's Refunding Mortgage Bonds or General Mortgage Bonds should remain outstanding (R. 1084-86). It was further provided that in the event of the foreclosure of the Refunding Mortgage or of the General Mortgage, the pledged Utah Fuel stock could be sold, still subject to the Western Consolidated Mortgage, and the net proceeds applied to the payment of the Refunding Mortgage Bonds and General Mortgage Bonds (R. 1089-90).

By another agreement, also dated December 20, 1924, the Debtor assigned to the General Mortgage Trustee (*i. e.*, this respondent) and to the trustee of the Refunding Mortgage all of the Debtor's rights and interests "in, to and under" the first agreement of December 20, 1924 (R. 1101).

Thus, in effect, this respondent has had since December 20, 1924, and still has, a junior lien upon the pledged Utah Fuel stock.

The Plan, after providing for the payment of 100% of the claim of the Western Consolidated Bondholders by the issuance of $20,056,400 in new securities of the reorganized Debtor, proposes, in addition thereto, to award to the Western Consolidated Bondholders *all* the stock of the Utah Fuel Company (R. 20-1).

One of the petitioners, Insurance Group Committee, represents owners of about 29% ($4,500,000 principal

amount) of the Western Consolidated Bonds; another of the petitioning group is Guaranty Trust Company as Trustee under the Western Consolidated Mortgage.

The petitioners aver in their brief that the Debtor, at the time of the December 20, 1924 transfer "did not then have, and did not thereby acquire, *any interest* in the Utah Fuel stock"; they note that the Debtor has never recorded that stock on its books but has uniformly carried the 1924 contract at $1. The reason the Debtor avoided technical title perhaps may be found in the so-called Elkins Act, being the "commodities clause" of the Interstate Commerce Act (49 U. S. C. A. Sec. 1 (8)), which, among other things, relates to interstate transportation by a railroad company of commodities manufactured, mined or produced by it or which it may own. That possibility is supported by statements of one of the Debtor's Trustees and counsel for the Debtor's Trustees (R. 1053-4).

Whatever the reason for handling the Utah Fuel stock in the manner above outlined, the statement that the Debtor did not thereby acquire "any interest" goes rather far. The Debtor became entitled to *all dividends* on the stock paid while any of the Debtor's General Mortgage Bonds or Refunding Mortgage Bonds should remain outstanding (except that, in the remote event that the Debtor at any time should have paid all bond interest and all accrued dividends on its preferred stock and appropriated funds to cover such interest and dividends for another year, then as long as that condition should continue, Utah Fuel dividends were to be paid directly to the Debtor's two stockholders) (R. 1085-6). This obligation to pay Utah Fuel dividends to the Debtor was to continue during the period that "any bonds or obligations

issued to pay or refund the General Mortgage Bonds or the Refunding Bonds * * * are outstanding" (R. 1085).

In the depression year 1934, the Debtor received a $250,000 dividend on this stock—a substantial return on an asset valued at one dollar (R. 77)! It is submitted that the practice of carrying contracts, patent rights and other property on the balance sheet at the nominal figure of $1 is not unusual and carries with it no presumption that the asset in question is worthless.

At the approval hearing on September 15, 1943, an officer of Guaranty Trust Company, the present trustee of the Western Consolidated Mortgage, while on the witness stand, agreed that the 1942 net earnings of Utah Fuel Company were about $415,000 and that net earnings for the first six or seven months of 1943 were about $535,000 (R. 1052).*

The Utah Fuel Company owns lands containing estimated reserves of about 112,000,000 tons of coal and in 1935 the daily mine capacity was 6,600 tons (R. 1098).

The testimony relating to the Utah Fuel stock was taken by the Commission in 1937. It is a matter of general knowledge that many coal companies throughout the country were going through dark days in 1935 and 1936. The Commission's 1942 report admits that the Utah Fuel "earnings are not of record since 1936,

* Moody's Manual of Investments—Industrial Securities, 1945 edition, p. 446, shows that total income of Utah Fuel in 1943 was $6,628,846, in 1944 $5,671,979; that net income in 1943 was $865,140, in 1944 $653,904; that earned surplus as of December 31, 1944 was $4,862,980 after listing the capital stock at $10,000,000. In addition there was a small capital surplus. Thus the 1943 figures, which were available to the General Mortgage Bondholders when they voted on the Plan, showed earnings that year of $8.65 per share on the Utah Fuel stock.

in which year, and in 1935, small amounts of net income were reported". All of these figures, of course, represent periods before the construction of one of the world's largest steel plants near Provo, Utah.

Even in 1937, before this development, it was testified by an expert that Utah Fuel during its next 40-year period could have an average expectancy of 1,200,000 tons a year from one part of its mines and 720,000 tons a year from another part, and that it could reasonably expect to have 20% of the total coal business in Utah (R. 811). The same expert testified that the coal properties were "more than ample" for a 40-year period or even a 70-year period (R. 810).

The Circuit Court of Appeals said, in part, with regard to this Utah Fuel stock:

> "There can be no question as to the duty resting upon these claimants [the Western Consolidated Bondholders] to credit the value of this collateral [the Utah Fuel stock] upon their claim before sharing in the securities of the reorganized company. They were entitled only to full payment. If the new securities which were assigned to them satisfied their claim in full, then the plan which permitted them to retain in addition this collateral would be inequitable and unfair to junior creditors.
>
> "The findings of the Commission are not clear as to the manner in which it treated this collateral. * * *
>
> "*Neither does the record establish with any degree of satisfaction the value of this collateral.* There is evidence which would support a conclusion that it had but little value. On the other hand, there is evidence that the Utah Fuel Company is now prosperous and is enjoying large

earnings, with reasonable prospects that they will continue;

"It appears to us that the plan contemplates that the claim of these creditors was to be *satisfied* from the new securities which were set apart for them; and that no particular value was ascribed to this collateral. If this collateral has any substantial value, it must be taken into account before the amount of new securities which are to be set over to these claimants is determined. *The Commission should clear up the doubts and uncertainties which surround this matter* when the proceedings are returned to it for further consideration" (R. 252-3; emphasis supplied).

SUMMARY OF ARGUMENT.

I. The Plan, after its rejection by 79.33% of the General Mortgage Bondholders who voted upon it, may not be confirmed under the provisions of Section 77(e) unless the Court is "satisfied and finds" that the Plan

"makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; affords due recognition to the rights of each class of creditors and stockholders;

does not discriminate unfairly in favor of any class of creditors or stockholders;

will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders;

and "that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts". Any confirmation by the District Court shall be "subject

to the right of judicial review" before it becomes binding on a class of creditors who have rejected the Plan.

The provision for confirmation of a reorganization plan in certain cases notwithstanding the failure to obtain the statutory two-thirds vote of acceptance—sometimes known as the "cram-down" provision—was incorporated into law by the amendments of August 27, 1935. "Arbitrary compulsion" was not intended. The purpose of the amendment was to take away from unreasonable minorities the absolute veto power they had previously possessed. It was intended that the cram-down should be used sparingly.

II. Under the statute the courts have no right to substitute their judgment for that of dissenting bondholders, if the dissenting bondholders have acted in good faith and in the exercise of an honest judgment. If a reasonable business man holding these Bonds could honestly conclude that the Plan was unfair to him, that is the end of the matter. Any other interpretation of the statute would make it a dead letter, and the submission to vote an idle gesture.

III. As the Plan has been construed, it fails to provide for the distribution to creditors of the full amount of the meager capitalization which the Commission found that the reorganized Debtor could properly support. At the same time 90% of the claim of the General Mortgage Bondholders remains unprovided for. For that reason, among others, it would be impossible properly to hold that the rejection was "not reasonably justified".

IV. Up to the end of 1944 there had been impounded for the benefit of the General Mortgage

Bondholders over 9 million dollars of surplus income, over and above full interest requirements of all creditors senior to the General Mortgage Bondholders. Under the Plan the General Mortgage Bondholders are called upon to accept a total of about 4⅓ million dollars of new common stock in full satisfaction of their 43½ million dollar claim.

Although approximately 66⅔% of the General Mortgage Bond interest (or $9,389,418 after full interest on all obligations senior to the General Mortgage Bonds) has been earned during the reorganization period, the Plan calls upon the General Mortgage Bondholders to accept in full satisfaction of their claim for principal and interest, about 12% of the common stock of the reorganized Debtor which, taken at $100 a share, totals only $4,354,816 in aggregate par amount or about 10% of their claim.

This obvious inequity does not permit the conclusion that the rejection vote was "not reasonably justified".

V. The Plan allots to some of the senior creditors, in addition to 100% of their total claim in new securities of the reorganized company, all of the outstanding 100,000 shares of Utah Fuel stock, upon which the General Mortgage Bondholders have a junior lien. That has been done in complete disregard of the rights of the General Mortgage Bondholders, without any determination as to the value of the Utah Fuel stock, although it seems obvious that such value is substantial. With such a serious shortcoming in the Plan, it would not be proper to hold its rejection "not reasonably justified".

VI. No plan at any time proposed by the senior creditors provided less than 47.42% treatment for the

General Mortgage Bonds; until July 27, 1942, no plan proposed by anyone provided that the General Mortgage Bonds should receive less than approximately one-third of their total claim in new stock. Thus, the senior creditors have admitted that the General Mortgage Bondholders are entitled to better treatment. The Commission has nowhere satisfactorily explained or justified the change from the 50% and 33⅓% treatment proposed in its first four plans to the 5% and 10% treatment proposed by it in 1942 and 1943.

The General Mortgage Bondholders have been presented with a paradoxical situation. During a period when the railroad is enjoying the greatest prosperity in its history, the General Mortgage Bondholders have been asked to accept the most drastic sacrifice ever suggested for them. It is that proposal which is "not reasonably justified", rather than the rejection of that proposal.

VII. All three judges of the Circuit Court of Appeals have held unanimously that the Plan is not fair and equitable. Even the District Court, which undertook to confirm the Plan over the rejection vote, indicated that it had some reluctance about doing so. The House Judiciary Committee was unanimously of the opinion that the Plan imposed "an unbearable hardship upon the junior investors". In the light of the foregoing, it cannot properly be held that the General Mortgage Bondholders were "not reasonably justified" in rejecting the Plan.

VIII. The General Mortgage Trustee offered the expert testimony of two admittedly well-qualified witnesses, Miles C. Kennedy and Ralph E. Morton, to the effect that in their opinion the rejection vote

was reasonably justified in the light of all the relevant facts. No testimony evidencing a contrary opinion was offered.

IX. Although it seems too clear for serious argument that the rejection vote in this case was not of an unreasonable type which the courts may properly override, it is also the fact that any confirmation of a reorganization plan under Section 77 in a case where the plan has failed to get the approval of even a bare majority of those voting of a class of creditors entitled to vote would be an unprecedented extension of the bankruptcy power. It would eliminate the line of reasoning followed by this Court in the *Rock Island* case in sustaining the constitutionality of Section 77.

X. The General Mortgage Trustee at no time has made any claim that the General Mortgage Bondholders should receive any of the surplus cash or any of the senior securities which have been "released" through the elimination of the Junction Bonds or which may become available through payment of the Chase note, reduction of any other senior claim, more appropriate treatment of the Utah Fuel stock, or otherwise. Far from being startled into saying that "the Circuit Court does not mean what it says" (petitioners' brief 54), this respondent observes that the Circuit Court does not mean what *the petitioners say* it says. A fair reading of the opinion below fails to disclose any requirement or direction that cash or senior securities be "distributed" to the General Mortgage Bondholders. Statements to that effect (petitioners' brief 32-33, 53, 54, 55, 87) are incorrect. The court below recognized that any distribution of cash or securities would be made to the

"various classes of creditors according to their priority in rank" (R. 246). When such a distribution or redistribution is made the senior creditors will receive in appropriate proportions securities of higher grade than offered them in the Plan. The common stock no longer needed for the senior creditors will then be available for distribution to the General Mortgage Bondholders.

ARGUMENT.

I.

The purpose of the August 27, 1935 amendments.

That part of Section 77(e) of the Bankruptcy Act which is here applicable provides that the Court, under certain carefully specified conditions, may confirm a plan which has failed to receive the statutory two-thirds vote of acceptance.

It is obvious that the intent of Congress in adding to Section 77 this so-called cram-down provision was to prevent selfish and unreasonable minorities from staging a hold-up, and to make it impossible for such minorities to take advantage of their nuisance value to drive an unconscionable bargain.

This seems clear enough, and for that reason any reference to the proceedings in Congress at the time of the adoption of the amendments may be superfluous, but in the appendix to this brief are excerpts from the committee reports and statements of those in charge of the bill in both Houses of Congress—which confirm what is said above regarding the intent and purpose of the provision (Appendix 12-32).

Sen. Rep. No. 1236 refers to the "obstructive possi-

bilities" in the *Missouri Pacific* case, with "72 different classes of security holders" and "one bank loan from J. P. Morgan & Co. * * * in a separate class" (Appendix 20).

Representative Summers, who was the judiciary committee member in charge of the bill in the House, in the course of the debate on the proposed amendment also referred to the *Missouri Pacific* case and its "72 classes" (Appendix 22), and Senator Wheeler, in charge of the bill in the Senate, in turn, mentioned the Missouri Pacific's 72 classes and the bank loan of J. P. Morgan & Co., separately classified, making it "impossible to get through a plan without either meeting the Morgan's terms or paying the value of their interest in cash" (Appendix 26).

Senator Hastings of the same committee also pointed to the 72 classes and to the possibility of "some man or some few people standing out, demanding 100 percent payment of their claims" (Appendix 29).

It obviously was the intent of Congress, as evidenced in the debates and reports on the bill, that the cramdown provision should be used sparingly. In the January 21, 1935 report of Joseph B. Eastman, Federal Coordinator of Transportation, on which the amendatory bill was based, Mr. Eastman stated (Appendix 13):

> "Arbitrary compulsion of plans over the dissents of the interested classes is not intended, nor is it believed that the courts will override strong dissents by any large number of such classes, or by a single large class, excepting where it is established that they have no interest in the property. Rather, the purpose is to prevent the obstruction of plans which are favored by the

larger classes of creditors or shareholders, but which are obstructed by minorities in the smaller classes in the attempt to secure unduly preferential treatment. * * *"

Senator Hastings stressed the protection given dissenting security holders by the provisions for appeal pointing out that the "court, of course, will go a long way before agreeing to that [the cram-down] if there be a real controversy" (Appendix 30) and that there was always "the right of appeal if the court dealt unfairly with them". Senator Wheeler mentioned the "double check" provided by the Commission and the Court, and Senator Hastings agreed, adding "there is a right of appeal to the circuit court from the decision of either of them" (Appendix 31).

It is also interesting to note that the same amendments were also intended "to protect the stockholders and creditors against unnecessary sacrifice" (Appendix 17, 21, 22-3, 24, 28). It was hoped to accomplish this through the so-called "rain check" provision of the bill. In commenting upon it, Representative Michener of the Judiciary Committee said:

"* * *. It guarantees to the last equity holder every possible chance to realize on his investment if business does pick up and the railroads again become profitable" (Appendix 24).

and Senator Wheeler reported:

"In a recent reorganization of an industrial concern many of the stockholders were completely wiped out. They were given no new stock. They received nothing at all.

"Then after reorganization business began to pick up because of more prosperous conditions,

but these stockholders who had invested their money remained completely wiped out, while other investors reaped the reward. This so-called 'rain check' device is to protect that class of stockholders" (Appendix 28).

II.

If a reasonable business man could honestly conclude that the Plan was unfair, the statute does not give the Courts power to override the rejection vote.

The petitioners erroneously assert that the Circuit Court of Appeals held that "the dissent of the General Mortgage Bondholders precludes confirmation of the Plan" (petitioners' brief 36, 100-106). An examination of the opinion below will show that it contains no such holding. The Circuit Court of Appeals pointed out numerous respects in which it found that the Plan was *inequitable* and *unfair* and *did not comply with the requirements of Section 77(e)* and *then* held: "It follows from what has been said that the General Bondholders were reasonably justified, within the meaning of the statute, in rejecting the plan, * * *" (R. 253). The Court decided, first, that because the Plan was not fair and equitable, the rejection vote was reasonably justified; and, secondly, that, because the Plan was not fair and equitable *and* because the rejection vote was reasonably justified, the District Court erred in confirming the plan (R. 253). That is very far removed indeed from a holding that a rejection vote "precludes" confirmation.

Under the statute, of course, a plan may not even be submitted to creditors for a vote until the District Court has held that it is fair and equitable. If the District Court's determination that the Plan is fair

and equitable were final, all of the statutory provisions for submission would be meaningless surplusage. In that event, the careful canvassing, supervision and tabulation of the vote by the Commission (R. 265-274) would be an indefensible waste of time and money. The fact would be that the Courts, the Commission and the creditors have been "shadow-boxing" since October 25, 1943—the "approved" date on which the District Court made that very determination—permitting the submission to creditors for a vote.

Clearly, the Congress cannot be presumed to have intended such futile procedure. The statute must mean what it says. The rejection vote may not be set aside unless it is determined affirmatively (and the District Court's decision is affirmed on appeal, if judicial review is requested) that the rejection was "not reasonably justified".

It should be noted that those rejecting the Plan are *not* required to establish that their action was "reasonably justified". The burden of proof is just the other way. Those who wish the Court to confirm the Plan notwithstanding its rejection must show by persuasive evidence, and by a preponderance of the evidence, that the rejection vote was not reasonably justified within the meaning of the statute. The supporters of the Plan completely failed to maintain that burden. On the contrary, the record affirmatively shows that the rejection vote was "reasonably justified" within the meaning of the statute.

If any reasonable business man could honestly have come to the conclusion the General Mortgage Bondholders reached, the rejection vote may not be set aside. Any other interpretation of the statute would make it a dead letter.

Under the statute the final safeguard is supplied

by requiring acceptance of the proposed composition by the creditors whose investment is at stake. Unless their action is not reasonably justified, their judgment controls.

The courts should not undertake to substitute their judgment for that of creditors, except under conditions indicating clearly that the creditors acted from improper motives or in an unreasonable, arbitrary or capricious manner. No such conditions here exist.

III.

As the Plan has been construed it fails to distribute completely the full amount of authorized securities which the Commission held that the reorganized Debtor could properly support.

As set forth in the Statement, the Plan as promulgated by the Commission provided for the issuance of $2,123,916 of new first mortgage bonds and $634,417 of new income bonds in exchange for the Junction Bonds. After the date of the Plan there was a substantial improvement in the Debtor's cash position and its net working capital. Mr. Thompson testified that on January 1, 1943, the proposed effective date of the Plan, the Debtor's Trustees had on hand cash and government bonds aggregating $10,850,000 (R. 278) and that on September 16, 1943 the total was approximately $20,000,000 (R. 278).

At a court hearing on September 14, 1943, the District Court ordered the payment or purchase of the Junction Bonds by the application of this "surplus cash" (R. 262-3).

After most of the Junction Bonds had been acquired by the Debtor's Trustees, the General Mortgage Trustee petitioned the Court for a redistribution of

those authorized securities which would no longer be required for issuance in exchange for the Junction Bonds (R. 637-640). It pointed to the provision of the Plan which it thought authorized such a redistribution and cited similar redistributions in other pending reorganization cases. The District Court, however, concluded that it did not have the power to make the redistribution or reallocation requested (R. 217).

As a result of that interpretation of the Plan it now appears that if the Plan were to be confirmed there would be outstanding approximately $2\frac{3}{4}$ million dollars less of authorized securities than was contemplated by the Commission. The reorganized Debtor will possess all of the property which the Commission determined would support the issuance of these new senior securities. It will have all the cash and all the working capital which the Commission deemed appropriate to sustain the operation of the reorganized Debtor. The Junction Bonds have not been "excluded", as suggested by the petitioners. They have been definitely included. They have been acquired by the Debtor's Trustees from surplus cash accumulated since the effective date of the Plan. They no longer remain outstanding as an unsatisfied lien upon the Junction property—which would be the only excuse for holding unissued the new first mortgage bonds and new income bonds in the Plan dedicated to the discharge of that lien.

If the $2\frac{3}{4}$ million dollars of authorized securities were not "redistributed", as prayed by this respondent and as the Circuit Court of Appeals indicates should be done (R. 250-1), the net result would be that the authorized capitalization of the reorganized company would be *decreased* by that amount—although

there has been no corresponding decrease in its earning capacity.

Under these circumstances the Plan as interpreted deals unnecessarily harshly with the General Mortgage Bondholders, 90% of whose claim is being forever wiped out. Their action in rejecting such a plan cannot properly be said to have been "not reasonably justified" within the meaning of the statute.

This feature of the Plan, as interpreted by the District Court, also clearly shows that the Plan fails to measure up to the requirements of Section 77(e).

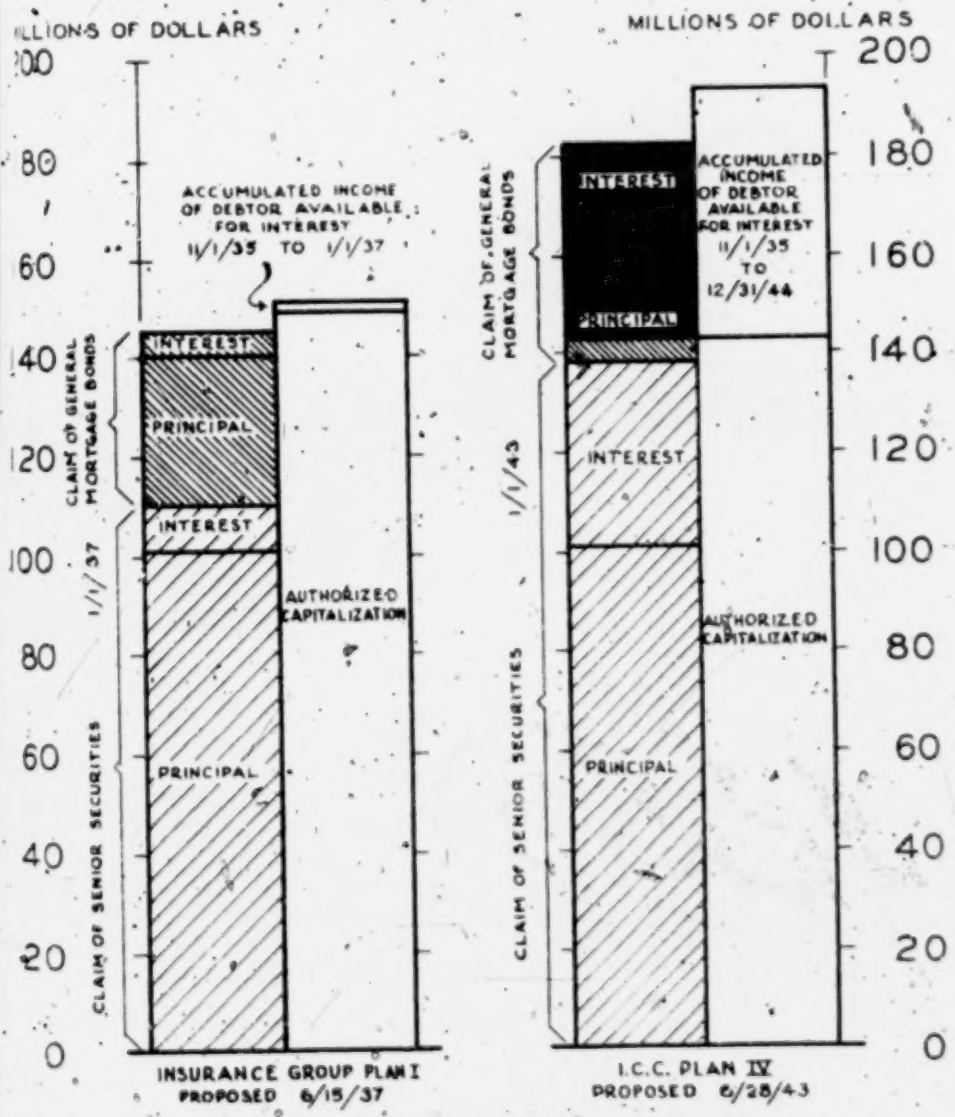
IV.

After the impounding for their benefit of over 9 million dollars of surplus income, the General Mortgage Bondholders were not acting unreasonably in rejecting a Plan giving them about 4⅓ million dollars of new stock in full satisfaction of their $43,548,155 claim.

The table on page 18 of this brief shows that up to the end of 1944 the Debtor's income had exceeded the interest requirements of all securities senior to the General Mortgage Bonds by $9,389,418. This is equal to about one million dollars a year available for application to payment of interest on the General Mortgage Bonds. Shortly after these reorganization proceedings started the General Mortgage Trustee made proper demand for the impounding of all net income from the mortgaged property for the benefit of the General Mortgage Bondholders (R. 376-398).

The supporters of the present Plan admitted in 1937 that the General Mortgage Bondholders were entitled then to receive 100% of their claim in new common stock, by proposing a plan which so pro-

TREATMENT OF GENERAL MORTGAGE CLAIM UNDER (1) INSURANCE GROUP PLAN OF 1937, AND (2) PLAN NOW UNDER CONSIDERATION



CLAIM OF SENIOR CREDITORS FOR WHICH NEW SECURITIES ARE PROVIDED.

CLAIM (OR PORTION OF CLAIM) OF GENERAL MORTGAGE BONDHOLDERS FOR WHICH NEW SECURITIES ARE PROVIDED

PORTION OF CLAIM OF GENERAL MORTGAGE BONDHOLDERS WIPED OUT

NOTE: AS OF 12/31/44 CLAIM OF SENIOR SECURITIES INCREASED BY $8.9 MILLIONS (ACCRUED INTEREST) AND DECREASED BY $4.0 MILLIONS (DEBT RETIREMENT) OVER AMOUNTS SHOWN WITH RESPECT TO I.C.C. PLAN IV

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, DEBTOR

the end of 1944, notwithstanding the accumulations of earnings substantially greater than the accumulation of unpaid interest on the claims of the senior creditors, the General Mortgage Bondholders, under a proposed capitalization of $143,528,027 have been almost shoved out of the picture by the interest accumulation on the senior debt, although that interest was earned with over $9,000,000 to spare.

Interest at the contract rate of 5% on $29,808,000 of General Mortgage Bonds amounts to $1,490,400 per year. Accordingly, during the reorganization period, over two-thirds of the interest, at the original contract rate, has been earned on all the outstanding General Mortgage Bonds. Involved in this nine-year period are the six worst years ever recorded for this Debtor (R. 348).

In the face of these facts, the Plan requires the General Mortgage Bondholders forever to forego 90% of their claim—to accept $4,354,816 of new common stock in full satisfaction. Obviously, their rejection of such a harsh and inequitable proposal cannot be set aside as "not reasonably justified".

V.

Because of the "bonus" to senior creditors of the Utah Fuel stock, on which the General Mortgage has a lien, the rejection vote cannot be held unreasonable.

The Plan provides that certain senior creditors, the holders of the Western Consolidated Bonds, shall receive 100% of their 20-million-dollar claim in new securities of the reorganized Debtor (R. 183). It also provides that these creditors shall receive all of the pledged Utah Fuel stock (R. 204, 167). The

pertinent facts regarding the Utah Fuel stock are set forth in the Statement. The 100,000 shares involved constitute all the outstanding stock of this corporation, which has no funded debt (R. 1110A).

The Circuit Court of Appeals says that it "appears to us that the plan contemplates that the claim of these creditors [the Western Consolidated Bondholders] was to be *satisfied* from the new securities [the securities of the reorganized Debtor] which were set apart for them, and that no particular value was ascribed to this collateral [the Utah Fuel stock]" (R. 253). That is a fair inference from the Plan language.

The Circuit Court of Appeals also held that the record does not "establish with any degree of satisfaction the value of this collateral" (R. 253).

The General Mortgage Bondholders, who are to receive only 10% of their claim under the Plan (R. 183), have a junior lien on the Utah Fuel stock, as well as certain other rights with respect thereto (this brief 26-31), and are entitled to share the benefit of that collateral after senior liens have been satisfied.

If the Utah Fuel Stock is now worth $20,000,000 as is not improbable, it is approximately equal in value to the entire claim of the Western Consolidated Bondholders, principal and accrued interest to the Plan's effective date, which totals $20,456,400 (R. 183). In other words, the allocation of the Utah Fuel stock, free and clear of the General Mortgage lien, to these senior creditors would approximately satisfy their claim. Under the Plan, however, they are to receive, in addition, $20,456,400 of assorted securities of the reorganized Debtor.

The petitioners seek to dispose of this troublesome

defect in the Plan by asserting that "Since the Utah Fuel stock is not property of the Debtor, it is not subject to disposition under Section 77 * * *". They admit that "* * * of course the Western Consolidated bondholders may not obtain a total realization, measured by actual value, that exceeds the amount of their claim". The petitioners assert that "* * * when enforcement of the pledge by distribution or sale is sought, * * * it will be appropriate in *those proceedings* to inquire whether such action will result in any excess realization" and that "Full protection can *then* be given to all those who have any junior interest in the stock" (petitioners' brief 94, 95).

Just how the junior lien of the General Mortgage Bondholders on this Utah Fuel stock is to be protected the petitioners do not make clear. Under the Plan the General Mortgage Bondholders are required to surrender their bonds for new common stock equal to 10% of their claim. Presumably the General Mortgage then goes out of existence. The new common stock is to be distributed to six different classes of creditors so that many of the holders of the new common stock will not be entitled to the protection of this junior lien on the Utah Fuel stock. It is the undisputed fact that the Western Consolidated Bondholders have a lien, limited to .6 million dollars in total amount, upon the Utah Fuel stock and everything over and above that amount stands as security for the Refunding Bonds and the General Mortgage Bonds. The Refunding Mortgage admittedly has a prior lien on all property covered by the General Mortgage. The Commission, by allowing the General Mortgage Bondholders to participate in the securities of the reorganized Debtor, has by that very fact determined that the Refunding Mortgage Bondholders are

already given all to which they are entitled. Accordingly the benefit of any surplus value over and above the amount required to satisfy the claim of the Western Consolidated Bondholders, clearly should go to the General Mortgage Bondholders.

It is submitted that if various classes of creditors of the Debtor have different rights and interests in the Utah Fuel stock, those rights should have been considered in the preparation of the Plan, and that these creditors should not immediately after consummation of the Debtor's reorganization be forced back into court for adjudication of their rights—merely on the theory that the Debtor does not have "any interest" in this stock.

Moreover the petitioners seem to overlook the provisions of the above-mentioned agreement of December 20, 1924 to the effect that in the event of foreclosure, if the trustee under the General Mortgage requests the sale of the Utah Fuel stock "such sale of the Utah Fuel Stock and application of the proceeds thereof shall be made *before the application to such payment of the property subject to such mortgages [meaning the Refunding Mortgage or the General Mortgage]*, or other indentures, or the proceeds thereof" (R. 1090; emphasis supplied).

Were this Plan to be consummated, the right of the General Mortgage Bondholders to participate in the security afforded by the Utah Fuel stock would be destroyed—and, in view of the rejection vote, clearly without their consent.

The petitioners cite the *Western Pacific* case* and erroneously argue that the claim of the Railroad

* *Ecker v. Western Pacific R. Corp.* (1943), 318 U. S. 448, 87 L. Ed. 892.

Credit Corporation there was handled similarly to the proposed treatment of the Utah Fuel stock. In the *Western Pacific* case the collateral was pledged by a third party; in our case it was pledged by the Debtor's predecessor. In the *Western Pacific* case no bond issues had any lien on the collateral; in our case three bond issues, including the General Mortgage, have a lien. In the *Western Pacific* case the accommodation collateral was not awarded to the Railroad Credit Corporation or to anyone else (rights were left unaffected); in our *Denver* case the pledged Utah Fuel stock is to be distributed exclusively among the holders of the Western Consolidated bonds (R. 20). No analogy exists.

The Circuit Court of Appeals has held that the "Commission should clear up the doubts and uncertainties which surround this matter" (R. 253).

The Plan treatment of the Utah Fuel stock, coupled with the inadequacy of the Commission's report with respect to (a) the value of the stock and (b) the theory upon which it was handed over to the senior creditors, free of any duty to account to the junior lienors, establishes with abundant clarity that the rejection vote was not unreasonable.

VI.

The senior creditors have admitted that the General Mortgage Bondholders are entitled to better treatment.

The treatment proposed for the General Mortgage Bondholders in eleven different plans is tabulated in the Statement (this brief 9), and is shown graphically on the charts opposite pages 12 and 19. Three

of these plans were proposed by the senior creditors, providing the following treatment for our Bonds:

Plan	General Mortgage Treatment
Insurance Group I	100%
Discussion	50%
Insurance Group II	47.42%

The sequence of the plans is also significant. At the outset the Insurance Group had no question but that the General Mortgage Bondholders should receive 100% of their total claim and, in fact, their 1937 plan gave these bondholders Class A common stock in that amount. Thereafter, in 1938-39-40, the Commission and its Examiner proposed three plans. In the first of these 50% treatment was provided for the General Mortgage Bonds and the other two reduced that percentage to 33⅓%. Promptly thereafter the senior creditors joined in putting forward the so-called Discussion plan, filed January 6, 1941, which brought back the General Mortgage treatment to 50%. It should be noted that the institutions which compose the group of senior creditors hold absolutely none of the General Mortgage Bonds and obviously would not have suggested increasing the allotment for the General Mortgage unless satisfied that this was demanded by considerations of equity and fairness.

In September of 1941 the Commission's Examiner made a new proposal, dropping the General Mortgage Bondholders to the same 33⅓% treatment previously proposed by the Commission. About a month after that, the Insurance Group Committee again came back with a counter-proposal, this time raising the General Mortgage treatment to 47.42%. That is the minimum treatment ever proposed for the General Mortgage Bonds by the senior creditors.

We cannot assume that the representatives of the

senior creditors proposed giving away to the General Mortgage any of the equity rightfully belonging to the bondholders they represented. The only proper inference to be derived from their successive proposals of 100%, then 50%, then 47.42%, for the General Mortgage Bonds is that they honestly were of the opinion that these percentages represented the least to which the junior bondholders were entitled. Unless they were satisfied as to this, it is apparent they would have been content to leave the General Mortgage Bonds with the treatment last previously proposed by the Commission. Obviously they were convinced that the Commission had dealt entirely too harshly with the General Mortgage.

Turning from the three plans proposed by the senior creditors to the six plans proposed by the Commission, the facts are as follows (see table, this brief 9):

Plan	General Mortgage treatment
Examiner's I	50%
ICC I	33⅓%
ICC II	33⅓%
Examiner's II	33⅓%
ICC III	5%
ICC IV	10%

Thus, the Commission and its Examiner in four successive plans, proposed in four successive years, consistently provided at least 33⅓% treatment for this bond issue. No one in the proceedings, no adverse party, had even suggested the possible desirability of making any reduction in the treatment of the General Mortgage Bonds. As already stated, the other parties had proposed just the opposite. The Commission made this drastic cut in 1942 and 1943, to 5% and 10%, of its own motion. It has not justified the change. It is submitted that the change cannot be justified.

The Commission held in 1943 that the Debtor's property would support a capitalization of $143,528,027 (R. 159, 184). In 1939 and 1940 it had held that the property would support a capitalization of about 135 million dollars (R. 352, 98-112). In the years 1941-43, plus the first seven months of 1944,* over 30 million dollars were spent on additions and betterments, over and above normal maintenance. Of this amount over 27½ million dollars were charged to capital account.

It would seem reasonable to assume that these additions and betterments would permit an increase in the capitalization, which the property could support, commensurate with the expenditures. Yet the Commission allowed an increase of only about 7¾ million dollars, or less than one-third the amount spent. This reflects no great confidence in the wisdom of these expenditures. The fact is, however, that the expenditures have greatly improved the earning capacity of the railroad as amply demonstrated by the operating results of more recent years.

It must be kept in mind, in this connection, that the income available for interest in 1942, when the first of these confiscatory plans was proposed, was $17,180,067,** and in 1943, when the other was proposed (the plan now under consideration), the income available for interest was $11,766,711.** The earnings during these two years were the highest thus far, during the reorganization period. In contrast, in 1939 (when the Commission proposed its first plan) it observed that the reorganization should not be "sub-

* These were the latest figures before the District Court at the hearing on confirmation. The amounts have increased substantially since then.

** These figures taken from tables on page 18 of this brief and were obtained as there explained. The 1943 Annual Report, p. 11 gives slightly different figures: for 1942—$17,044,420.39; for 1943—$11,573,667.94.

jected to undue delay pending a demonstration that the carriers can again earn more than $3,000,000 a year" (R. 67).

The Commission's second supplemental report of July 13, 1942, contains a statement that "The trend of earnings indicates that in 1942 the debtors' forecast for a future normal year, showing an available income of $6,215,423 will be exceeded" (R. 124). That was at least an understatement in view of the actual figure of $17,180,067 (this brief 18). The same report carefully made provision for a $2,250,000 note to the R. F. C. for "new money" (R. 145).

In its June 14, 1943 report the Commission noted the 1942 earnings figures, as well as the figures for the first two months of 1943, and as a result, "eliminated, as an item of the new capital structure" the 2¼-million-dollar note for "new money" (R. 155-6). The Commission still included provisions, however, for new borrowing from the R. F. C. in an amount up to $2,000,000 in connection with the reorganization and, in the alternative, for the issuance of an additional $2,250,000* of new first mortgage bonds (R. 156).

The 1942 and 1943 plans provided for substantially the same authorized capitalization (this brief 9; R. 183, 355), which was only about 7¾ million dollars more than the lowest capitalization ever suggested for this Debtor—that proposed in July 1939 after the worst 4½ years recorded for this property (R. 348).

The record shows that there is a substantial prospect of this railroad earning enough to enable the General Mortgage Bondholders to recoup all of their investment. A fair and equitable plan would give them such an opportunity. Giving them common stock would add nothing to the fixed charges, and in no way jeopardize the road's financial stability, yet would

* The Plan itself gives this figure at $2,500,000 (R. 23).

give them the benefit of earnings in excess of those necessary to cover the securities allocated to senior creditors. The Plan denies them that chance.

The fact of the matter is that the General Mortgage Bondholders were lost sight of, or disregarded. They were caught in a squeeze. The table on page 9 of this brief shows that the authorized capitalization in all the plans did not fluctuate greatly. This is shown graphically at the top of the chart which appears opposite page 42. Thus the ceiling remained fairly constant above them. Beneath them, however, there was a steadily rising floor representing the claim of the senior creditors, including accrued unpaid interest. Just how this floor rose can be shown by comparing the principal of the senior claims* with the total claims, principal plus interest, to January 1, 1943, provided for in the Plan (R. 183):

Description of Senior Debt	Principal of senior claims December 31, 1935	Claims principal plus interest to Jan. 1, 1943
R. G. West. First Trust 4's	$ 15,150,000	$ 20,050,800
R. G. West. Cons. 4's	15,089,000	20,056,490
R. G. June. First 5's	2,000,000	2,758,333
D. & R. G. Consol. 4's	34,125,000	45,727,500
D. & R. G. Consol. 4½'s	6,382,000	8,823,115
Refunding & Impt. 5's	12,000,000	16,950,000
Refunding & Impt. 6's	2,000,000	2,990,000
Chase National Bank Note	1,500,000	2,158,458
R. F. C. Notes	10,691,850	12,900,605
Equipment obligations	2,325,000	5,758,000†
TOTALS	$101,293,850	$139,173,211

* 1935 Annual Report, pp. 13, 14.

† The increase in equipment obligations is due to money borrowed by Trustees for purchase of *new* equipment and for *improvements* in the Debtor's property, *not* accumulated interest. This amount is included in the tabulation because the Commission allows this new debt (representing *part only* of the value of *new* equipment and of *new* additions and betterments now belonging to the Debtor) to combine with the accumulated interest on the senior debt in squeezing out the General Mortgage Bondholders.

Thus, during that period there was an increase in the total of claims senior to the General Mortgage Bonds amounting to $37,879,361. That increase is approximately equal to the face amount of claim which the General Mortgage Bondholders under the Plan are asked to give up, $39,193,339.

During the reorganization, through July 31, 1944, the last month-end prior to the confirmation hearing, the Debtor's Trustees had spent over $54,373,238 for improvement of the Debtor's property over and above normal maintenance, of which $43,291,513 was charged to capital account in accordance with the rules and regulations of the Commission (table, this brief 13).

There was no corresponding increase in authorized capitalization.

The above facts account for the "squeeze" just mentioned. There was a constantly shrinking margin between (a) the total amount of authorized securities, available for distribution to all creditors, on the one hand, and (b) the total amount of the senior claims, on the other. At the outset the margin was wide enough to accommodate the entire claim of the General Mortgage Bondholders. Under the Plan the margin had shrunk to such an extent that 90% of the General Mortgage claim had been squeezed out.

Elsewhere, we discuss the elimination, through the use of surplus cash earned after the promulgation of the Plan, of the Junction Bonds. As a result of the payment or purchase of the Junction Bonds the "steadily rising floor" should be at least $2,758,333 lower because at least that amount of the senior claims no longer need be provided for out of the authorized securities, but that adjustment has not been made.

If the Utah Fuel stock is properly valued and

handled, as discussed previously, perhaps the "floor" may be lowered another 10 or 15 million dollars.

Looking at this sequence of events from the point of view of a General Mortgage Bondholder, the situation appears a Gilbertian paradox. Here were eleven successive plans. The first five were proposed in years in which the earnings were poor—not even sufficient to cover the senior bond interest. These five plans proposed giving the General Mortgage Bondholders a substantial part of their claim in new securities, the several percentages being 100%, 100%, 50%, 33⅓%, and 33⅓%.

In contrast came six later plans, all of which were proposed in years of substantially better earnings—in every one of which all senior bond interest was earned. Only one of these six plans (the Discussion plan) suggested as much as 50% treatment for the General Mortgage. The last two plans, proposed during years of maximum prosperity (to date), dropped the luckless General Mortgage Bondholders to 5% and 10%, respectively.

The paradox is shown in tabular form in the Statement (this brief 11), and more graphically by the charts opposite pages 12 and 19.

What made it even more difficult for a General Mortgage Bondholder to understand the sequence was the fact that no security holder, at any time, ever suggested that the General Mortgage Bondholders were given too favorable treatment in any proposed plan. On the contrary, the other parties consistently proposed improving the treatment of the General Mortgage.

With the enormous earnings prevailing in 1942 and 1943, the unexpectedly drastic cut in the allotment provided for the General Mortgage in the Commission's last two plans appeared completely unreasonable to a

General Mortgage Bondholder; and, when he voted, in 1944, the railroad was having another banner year.

With that background, it seems self-evident that the action of the General Mortgage Bondholders in rejecting the Plan was not unreasonable.

VII.

In the light of the views expressed by the Circuit Court of Appeals, by the District Court, and by the unanimous House Judiciary Committee, it cannot properly be held that the General Mortgage Bondholders were "not reasonably justified" in rejecting the Plan.

For various reasons set forth in its opinion, the Circuit Court of Appeals found that the Plan "is inherently inequitable and unfair" (R. 247), that it has an "inherent weakness" (R. 248), that the General Mortgage Bondholders "have a real grievance" (R. 248), that the Plan "does not comply with the requirements of Section 77(e)" (R. 251), and that the Plan "fails to meet the requirements" of that Section (R. 253).

The District Court itself, in the very opinion which overrode the rejection vote of the General Mortgage Bondholders and confirmed the Plan notwithstanding its rejection, indicated that it had some reluctance in the matter. It pointed out that it had previously itself put forward a plan giving the General Mortgage Bondholders a larger amount of common stock but that it had been overruled by the Commission. The District Court felt that it would be "a useless gesture" for it to do the same thing again. As if interpreted the decision of this Court in the *Milwaukee* case* it

**Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* (1943), 318 U. S. 523, 87 L. Ed. 859.

apparently felt that it was forced to go along with the Commission. The District Court said (R. 221):

> "The court, in its plan of March 6, 1941 gave the General Mortgage bondholders more common stock than does the approved plan. The Commission, however, could not agree with our views, and it would seem to be a useless gesture for the court to make the same error again assuming we had the power."

Extracts from an unanimous report of the House Judiciary Committee (78th Cong., 2d Sess., Rep. No. 1615), recommending the passage of H. R. 4960, are included in a footnote to the concurring opinion of Circuit Judge Phillips (R. 255-9). That report referred specifically to our *Denver* case, pointing out that in 1942 the Denver & Rio Grande system earned $34.40 a share on its common stock (after all prior charges) and that the same figures were repeated approximately in 1943 and were continuing in 1944. The report stated: "That this situation has created an unbearable hardship on the junior investors in railroad securities * * * may be easily seen * * *."

It seems clear from this and other language of the unanimous report that the members of the Judiciary Committee did not consider the Plan fair and equitable and, if called upon to vote on the Plan, would have rejected it.

The petitioners would have this Court rule that the General Mortgage Bondholders whose views about the Plan apparently coincide with the unanimous Circuit Court of Appeals and with the unanimous House Judiciary Committee were "not reasonably justified" in holding those views and in voting, accordingly, to reject the Plan.

VIII.

The rejection vote was "reasonably justified" in the opinion of the only witnesses called to give expert testimony.

At the hearing before the District Court on the confirmation of the Plan, the significance of many uncontroverted facts, discussed earlier in this brief, with respect to the vital question of whether or not the rejection vote was one that could properly be overridden as "not reasonably justified" was covered by the expert testimony of the witness, Miles C. Kennedy.

Mr. Kennedy is a member of the consulting engineering firm of Coverdale & Colpitts. The District Court and counsel for the Insurance Group Committee and the R. F. C. waived all testimony offered as to the qualification of this witness and conceded that Mr. Kennedy and his firm have in a very large number of railroad reorganization cases served as special advisors to bondholders, bondholders' committees, creditors' groups, and the like. All conceded Mr. Kennedy's expert professional experience and qualifications.

The significance of Mr. Kennedy's testimony best appears from an examination of it in its entirety (R. 310-334). For the convenience of the Circuit Court of Appeals, an abstract of part of Mr. Kennedy's testimony was prepared and it has been reprinted in the appendix to this brief (Appendix 1-8).

Mr. Kennedy's testimony was supplemented by that of the witness, Ralph E. Morton, a vice president of City Bank Farmers Trust Company, the trustee under the General Mortgage (R. 335-342). An abstract of

part of Mr. Morton's testimony is printed in the appendix (Appendix 9-11).

After extended preparation, the respective expert opinions of these witnesses was asked on whether the rejection vote was "reasonably justified in the light of all the relevant facts". The District Court received an opinion from Mr. Kennedy that the rejection was reasonably justified (R. 319-20; Appendix 6-7), but sustained an objection to an opinion to the same effect from Mr. Morton (R. 335; Appendix 11).

IX.

Confirmation of a Plan which has failed to get even a bare majority approval would be an unprecedented extension of the bankruptcy power.

The contention of the senior creditors that this Plan should be crammed down the throats of the General Mortgage Bondholders after they have rejected it by a vote of 4 to 1 and after a unanimous Circuit Court of Appeals has held that the Plan is unfair and inequitable as to them, raises a serious constitutional question. Forcing such a plan upon holders of bonds, secured by a duly recorded mortgage, involves the confiscation of property rights of the highest type. We are dealing with railroad mortgage bonds, a type of security in which the public has been accustomed to invest its savings.

The confirmation of the Plan would involve confirming a plan which not only has failed to obtain the two-thirds vote of acceptance prescribed in Section 77 (e) as amended, but *also has failed to obtain even the approval of a majority of the General Mortgage Bondholders voting.*

Counsel for the Insurance Group insist that it is no longer possible to challenge the constitutionality of Section 77 and cite the comprehensive analysis of that statute by this Court in the *Rock Island* case,* in which the constitutionality of Section 77 was sustained.

Section 77 was amended in a very important respect after the date of that decision. The later amendment took from the statute the very provision on which this Court heavily relied in sustaining the statute's constitutionality.

In the *Rock Island* case this Court, in passing upon the constitutionality question, pointed out that, under the statute as it then stood,

> "No plan may be finally approved by the Commission until it has been accepted in writing by or on behalf of creditors holding two-thirds in amount of the claims of each class affected by the plan * * *." (294 U. S. 663)

and that

> "Upon confirmation of the plan, it is to be binding not only upon corporation and all stockholders and creditors generally, but upon all secured creditors of each class of which two-thirds in amount shall have accepted the plan." (p. 663)

After referring to Article I, Section 8, Clause 4, of the Constitution, which vests Congress with the power to establish bankruptcy laws (p. 667), this Court reviewed their development (pp. 667-675), and said:

> "But, while it is true that the power of Congress under the bankruptcy clause is not to be limited

* *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Railway Co.* (1935), 294 U. S. 648, 55 Sup. Ct. 595, 79 L. Ed. 1110.

> by the English or Colonial law in force when the Constitution was adopted, it does not follow that the power has no limitations." (p. 669)

This Court then continued its historical review by pointing out that by the act of 1867, as amended by the act of 1874,

> "the debtor for the first time was permitted either before or after an adjudication in bankruptcy, to propose terms of composition to his creditors to become binding *upon their acceptance by a designated majority* and confirmation by the judge." (p. 671; emphasis supplied).

Returning to the application of the bankruptcy statutes to railroads and specifically to Section 77, this Court said:

> "As outlined by that section [i. e. Section 77, as it *then* stood], a plan of reorganization, when confirmed, cannot be distinguished in principle from the composition with creditors authorized by the act of 1867, as amended by the act of 1874. * * * The constitutionality of the old provision for a composition is not open to doubt." (p. 672; part in brackets supplied).

This Court then turned to a discussion of the *Gebhard* case,* also cited by the petitioners. In the *Rock Island* case this Court quoted from its opinion in the *Gebhard* case as follows:

> "The confirmation and legalization of 'a scheme of arrangement' under such circumstances is no more than is done in bankruptcy when a 'composition' agreement with the bankrupt debtor, *if*

* *Canada Southern Railway Company v. Gebhard* (1883), 109 U. S. 527.

assented to by the required majority of creditors, is made binding on the non-assenting minority." (pp. 673-4; taken from 109 U. S. p. 536; emphasis supplied).

This Court concluded in the *Rock Island* case that

> "It follows, from what has now been said, that § 77, in its general scope and aim, is within the power conferred by the bankruptcy clause of the Constitution; and we so hold." (p. 675)

Thus, it was by analogy to "compositions" that Section 77 was found to be constitutional.

To the extent that Section 77, as amended, permits a court to confirm a plan *which has been accepted by a majority of the secured creditors of each class*—notwithstanding the fact that it has failed to receive a two-thirds vote of acceptance—it would seem that the same line of reasoning or analogy to bankruptcy compositions, which this Court followed in the *Rock Island* case, would sustain the *amended* statute.

The *North Western* case* is cited by the petitioners as "ending all constitutional doubt" on this subject. There was *dictum* in the District Court opinion in that case to the effect that a plan may be confirmed notwithstanding the size of the rejection vote but a careful examination of the case discloses that the statement was *dictum* only, that that question was not presented by the facts, was not argued to the Court and that the decision of that question was not necessary to a decision of the case. The fact was that a *majority* (50.37%) of the holders of the State

* *In re Chicago and North Western Railway Co.*, 7th C. C. A. 1942, 126 Fed. 2d 351, cert. denied (1943) 318 U. S. 793.

Line Bonds voting on the plan had voted to *accept* the plan. The question presented for decision was merely whether a plan could be confirmed which, although accepted by a majority vote of a class of creditors, had failed to receive the two-thirds vote mentioned in the statute. The opinion of the C. C. A. does not refer to the point specifically but a footnote to it quotes the following from the District Court opinion:

> "Furthermore, the power to confirm a composition over the objection of 33⅓% of the creditors is exactly the same kind of a power as the power to confirm a composition over the objection of 49.63%; * * *."

That much of the sentence quoted is not *dictum* and does not go beyond the facts and argument of the case there under consideration, but the District Court continued, with the following unsupported and uncalled-for *dictum:*

> "or for that matter over the objection of 100% of them. It is a bankruptcy power. * * *" (126 Fed. 2d 365-6, footnote 9, taken from June 25, 1941 unreported opinion of the District Court, *North Western* printed record Vol. 9, pp. 5428-9).

An examination of the briefs filed in the *North Western* case on behalf of Irving Trust Company, as trustee of the State Line Mortgage, and its opponents, indicates that no argument was made to the court relative to the effect of a majority *rejection*. That fact was not there present.

Recently, in the *New Haven* case,* the District Court has undertaken to confirm a plan notwithstand-

* *In re New York, New Haven & Hartford Railroad Co.* (D. C. D. Conn. 1945).

ing the fact that only 49.40% of the Old Colony bondholders voting accepted the plan. That decision has been appealed to the Circuit Court of Appeals for the Second Circuit and that appeal is now pending.

One fundamental limitation upon the bankruptcy power would seem obviously to be that no secured creditor may be compelled to surrender his security and to take something else in lieu of it unless the arrangement has at least been approved by a *majority* of the voting creditors of his class. Without that minimum safeguard, reorganization procedure would become reorganization by mere judicial (and Commission) fiat. . . .

This Court observed in the *Radford* case* that:

> "The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment." (p. 589).

The *Radford* case dealt with a question arising under the so-called Frazier-Lemke Act, which added to Section 75 of the Bankruptcy Act sub-section (s) relating to farmers who had failed to obtain the consents requisite to a composition under that Section. In holding the Frazier-Lemke Act unconstitutional, this Court observed:

> "Although each of our national bankruptcy acts followed a major or minor depression, none had, prior to the Frazier-Lemke amendment sought to compel the holder of a mortgage to surrender to the bankrupt either the possession of the mortgaged property or the title, so long as any part of

* *Louisville Joint Stock Land Bank v. Radford* (1935), 295 U. S. 555; 79 L. Ed. 1593.

the debt thereby secured remained unpaid." (pp. 581-2).

* * * *

"In no case of composition is a secured claim affected except when the holder is a member of a class; and then *only when the composition is desired by the requisite majority and is approved by the court.*" (pp. 585-6; emphasis supplied).

In discussing the power of the bankruptcy court to enforce a composition between creditors, this Court further observed:

"It is the same power, which a court of equity exercises when it compels dissenting creditors, in effect, to submit to a plan of reorganization approved by it as beneficial and assented to by the requisite *majority* of the creditors. *Shaw* v. *Railroad Co.*, 100 U. S. 605; *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445. Compare *National Surety Co.* v. *Corlett*, 289 U. S. 426; *First National Bank* v. *Flershem*, 290 U. S. 504" (p. 585; emphasis supplied).

As above stated, the Frazier-Lemke Act was held unconstitutional.

The August 27, 1935 amendments to Section 77 are discussed in a Columbia Law Review article "Amendment of the Railroad Reorganizaton Act" (1936—Henry J. Friendly), 36 Col. Law Rev. 27. After observing that the provision for confirmation of a plan notwithstanding its rejection "raises constitutional questions of the most serious character" (p. 32) and after referring to this Court's decision in the *Rock Island* case, previously discussed in this brief, the article points out that the *Rock Island* decision "was based specifically upon the analogy of a composition, which if assented to by the required

majority of the creditors, is made binding on a 'non-assenting minority'." (pp. 34-5). The law review article then goes on to say:

"*The history of composition and adjustment legislation both in England and in the United States reveals a consistent adherence to this principle of majority rule.* English composition statutes have always required the assent of *at least a majority* in number and amount of the creditors, and since 1869 they have required a majority in number and three-fourths in amount. In this country, the act of 1874, which introduced the principle of composition into our bankruptcy legislation, required the adherence of a majority in number and three-fourths in amount of the creditors present at the meeting and subsequent written confirmation by two-thirds in number and one-half in amount. The present Bankruptcy Act requires a majority in number and amount. The English Railway Companies Act of 1867, and the Joint Stock Companies Arrangement Act, the pioneer corporate reorganization statutes, demanded a vote of three-fourths in value of each class of security holders. With a single exception, the recent Federal legislation for the relief of debtors enacted prior to the present amendment has required either a two-thirds or a majority vote of a class affected by a plan and not otherwise protected.

"The fate of that exception, the Frazier-Lemke Act of June 28, 1934, *affords no ground for optimism as to the constitutionality of the provision under discussion*,—at least as applied to secured creditors. * * * *the Supreme Court's opinion holding the Frazier-Lemke Act unconstitutional reveals that there is serious question whether a secured creditor can be forced to accept even the*

fairest substitute for his security in the absence of assent by a majority of the class. * * *" (pp. 34-5; emphasis supplied).

Later on in the article, the following appears:

"* * * *the history as to compositions and schemes of adjustment is not to be lightly disregarded.* This history shows a general belief, both in England and in this country, that a creditor cannot fairly be deprived of his rights to have his security or his debtor's property applied to the satisfaction of his demands *except when enforcement of his will would obstruct a greater number of his class from achieving their reasonable desires.* The ultimate question is whether this belief is so deeply rooted in our thinking that its violation is a denial of due process of law. * * * *But it must be something more than an accident that, so far as has been discovered, no English or federal statute* (except the Frazier-Lemke Act) *has ever before authorized the court to interfere finally with a creditor's right to reach his security except when the judgment of the court and that of a majority of the class of creditors concurred.* Whether a plan is fair to a given class of security holders is a question not of law but of business judgment on which a court is peculiarly likely to err, and *it is sound policy to require the judgment of the court to be supplemented by the views of the persons whose investments are actually at stake.* Certainly the framers of the amendment were mistaken in thinking that because the court will not bind a minority when it believes the minority to be right, it follows as an irresistible conclusion that the court may constitutionally be empowered to bind a majority in cases where it believes the majority to be wrong." (p. 36; emphasis supplied).

CONCLUSION.

Under the admitted facts in the record, many of which are reviewed in the Statement, and for each of the several reasons set forth in the Argument, it is clear that the Circuit Court of Appeals was correct in its "conclusion that the Plan fails to meet the requirements of Section 77(e)" and "* * * that the General [Mortgage] Bondholders were reasonably justified, within the meaning of the statute, in rejecting the plan, * * *". Accordingly, the Plan should be referred back to the Commission for further proceedings as provided in the statute and as directed by the Circuit Court of Appeals for the Tenth Circuit.

Respectfully submitted.

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February 15, 1946.